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Unsecured Creditors of Sears Holdings Corporation, et al.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	Chapter 11
SEARS HOLDINGS CORPORATION, *et al.*,	Case No. 18-23538 (RDD)
Debtors.[1]	(Jointly Administered)

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS TO ESL INVESTMENTS, INC.

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are as follows: Sears Holdings Corporation (0798); Kmart Holding Corporation (3116); Kmart Operations LLC (6546); Sears Operations LLC (4331); Sears, Roebuck and Co. (0680); ServiceLive Inc. (6774); SHC Licensed Business LLC (3718); A&E Factory Service, LLC (6695); A&E Home Delivery, LLC (0205); A&E Lawn & Garden, LLC (5028); A&E Signature Service, LLC (0204); FBA Holdings Inc. (6537); Innovel Solutions, Inc. (7180); Kmart Corporation (9500); MaxServ, Inc. (7626); Private Brands, Ltd. (4022); Sears Development Co. (6028); Sears Holdings Management Corporation (2148); Sears Home & Business Franchises, Inc. (6742); Sears Home Improvement Products, Inc. (8591); Sears Insurance Services, L.L.C. (7182); Sears Procurement Services, Inc. (2859); Sears Protection Company (1250); Sears Protection Company (PR) Inc.(4861); Sears Roebuck Acceptance Corp. (0535); Sears, Roebuck de Puerto Rico, Inc. (3626); SYW Relay LLC (1870); Wally Labs LLC (None); SHC Promotions LLC (9626); Big Beaver of Florida Development, LLC (None); California Builder Appliances, Inc. (6327); Florida Builder Appliances, Inc. (9133); KBL Holding Inc. (1295); KLC, Inc. (0839); Kmart of Michigan, Inc. (1696); Kmart of Washington LLC (8898); Kmart Stores of Illinois LLC (8897); Kmart Stores of Texas LLC (8915); MyGofer LLC (5531); Sears Brands Business Unit Corporation (4658); Sears Holdings Publishing Company, LLC. (5554); Sears Protection Company (Florida), L.L.C. (4239); SHC Desert Springs, LLC (None); SOE, Inc. (9616); StarWest, LLC (5379); STI Merchandising, Inc. (0188); Troy Coolidge No. 13, LLC (None); BlueLight.com, Inc. (7034); Sears Brands, L.L.C. (4664); Sears Buying Services, Inc. (6533); Kmart.com LLC (9022); and Sears Brands Management Corporation (5365). The location of the Debtors' corporate headquarters is 3333 Beverly Road, Hoffman Estates, Illinois 60179.

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The Official Committee of Unsecured Creditors (the "Creditors' Committee") of Sears Holdings Corporation ("Holdings") and its affiliated debtors and debtors in possession (collectively, the "Debtors" and, together with their non-Debtor affiliates, "Sears" or the "Company") in the above-captioned chapter 11 cases (the "Chapter 11 Cases"), by and through its undersigned counsel, hereby files this objection (the "Objection") to the proposed sale of substantially all of the Debtors' businesses and assets to Transform Holdco, LLC ("Buyer" and, together with its affiliates and principals, including ESL Investments, Inc., "ESL") pursuant to section 363(b) of title 11 of the United States Code (the "Bankruptcy Code"). In support of this Objection, the Creditors' Committee respectfully states as follows.

PRELIMINARY STATEMENT[2]

1. The Debtors' process for the sale of their assets was supposed to be multifaceted, including both a "go forward" sale process and a "sum of the parts" sale process. With respect to the go forward sale process, the Debtors initially were to solicit bids for the sale of over 500 of the Debtors' operating stores that would continue as a "going concern." The primary stated objectives in pursuing a going concern transaction were laudable: (i) ensuring the Debtors' administrative solvency and (ii) saving up to 45,000 jobs. But the true intended beneficiaries of such process were the Debtors' former CEO and Chairman of the Board, Edward S. Lampert ("Lampert") and his hedge fund, ESL Investments, Inc. Indeed, since early in these cases, the Debtors have acknowledged that ESL likely was the only "going concern" bidder and would seek to credit bid nominally secured claims—claims that the Debtors acknowledged were subject to significant dispute—as part of its bid.

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[2] Capitalized terms used but otherwise not defined in this section shall have the meanings ascribed to such terms elsewhere in this Objection.

2. The sum of the parts sale process was to be markedly different from the going concern sale process. In connection with the sum of the parts process, the Debtors were to (i) obtain bids from liquidators to conduct GOB sales at all of their operating stores; (ii) market their extensive real estate portfolio comprising over [redacted] separate owned and leased properties; (iii) market their various business lines including Sears Home Improvement, Sears Home Services, Sears Auto Centers, PartsDirect, Innovel and Monark; and (iv) market their other remaining assets. As part of this process, also referred to as the GOB or wind-down process, the Debtors always maintained that they would be administratively solvent.

3. A significant number of the Debtors' assets to be sold in connection with either the go forward or the GOB sale process are unencumbered, including each of the business lines noted above and [redacted] real estate assets with significant aggregate value. The majority of the Debtors' other assets currently are encumbered by a significant amount of secured debt obligations. Certain of these secured debt obligations arose from "regular way" financings from reputable third party lenders, such as the lenders under the Debtors' first lien asset backed lending facility, which is secured by liens on accounts receivable (and related cash proceeds) and inventory. The vast majority of the Debtors' other "secured debt obligations," however, arose from insider financing transactions with ESL. The ESL-centric financing facilities were put in place while Sears was lying on its deathbed following a series of spin-off transactions, like Seritage and Lands' End, that lined Lampert's and ESL's pockets while stripping Sears of its most valuable business lines and real estate assets. These financing transactions were papered as debt obligations, but have significant *indicia* of being equity contributions and were supported by financial projections artfully, but artificially, manufactured by Lampert. Indeed, as discussed in

detail in the Creditors' Committee's Standing Motion and Proposed Complaint[3] and summarized herein, the Creditors' Committee is seeking to pursue colorable and highly valuable causes of action against Lampert and ESL in connection with fraudulent spin-off transactions and the incurrence of the ESL financing facilities, including causes of action to equitably subordinate and/or recharacterize ESL's claims against the Debtors' estates—claims that ESL is seeking to use as credit bid consideration for its acquisition of not just 425 stores, but substantially all of the Debtors' assets. The Debtors are proposing to release a significant portion of these causes of action, including with respect to the allowance and treatment of the ESL Claims,[4] for the *de minimis* amount of $35 million.

4. As noted above, although only ESL was ever interested in making a "go forward stores" bid, numerous parties were interested in the Debtors' assets in connection with a sum of the parts sale process. In order to determine the values that the Debtors' estates could obtain in connection with the sum of the parts process, however, the Debtors were required to formulate and run a robust and fair sale process. Unfortunately, the Debtors were never prepared to undertake—and, thus, never undertook—such a process. As a result, the Debtors have been unable to determine the values that could have been obtained in connection therewith to compete with ESL's purported "going concern" bid.

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[3] *See Motion of the Official Committee of Unsecured Creditors of Sears Holdings Corporation,* et al. *for Entry of an Order Granting (I) Leave, Standing, and Authority To Commence and Prosecute Certain Claims on Behalf of the Debtors' Estates and (II) Non-Exclusive Settlement Authority in Respect of Such Claims*, dated January 17, 2019 [ECF No. 1765] (the "Standing Motion" and the underlying draft complaint attached thereto, the "Proposed Complaint"). Contemporaneously herewith, the Creditors' Committee has filed the *Preliminary Omnibus Objection of the Official Committee of Unsecured Creditors of Sears Holdings Corporation,* et al. *to the ESL Proofs of Claim* (the "ESL Claims Objection"), formally disputing the allowance of ESL's secured claims reflected in its proofs of claim, as set forth on Schedule G of the APA (the "ESL Claims"). Each of the Standing Motion, Proposed Complaint and ESL Claims Objection is expressly incorporated herein by reference as if fully set forth herein and are part of the record before the Court in connection with this proceeding.

[4] The Creditors' Committee reserves its rights to object to, or otherwise challenge, any and all of ESL's unsecured claims that it has asserted or may assert against the Debtors' estates.

5. The fact that the Debtors did not run a comprehensive process to compete with ESL is unsurprising. Indeed, the Debtors never were prepared for—and at no point during the pendency of these cases have the Debtors seriously engaged in—efforts to truly test the market for what their assets are worth. As a result, the "auction" process itself was exclusionary and noncompetitive, amounting instead to a one-horse race to transfer Sears and its valuable assets and operating businesses to ESL in exchange for consideration that allowed the Debtors to get closer to, but not achieve, administrative solvency and without regard to the value of unencumbered assets or distributions to the Debtors' general unsecured creditors. Indeed, under the Creditors' Committee's analysis, the ESL Bid undervalues the Debtors' unencumbered assets by approximately [redacted], on the low end, to [redacted], on the high end, and provides no consideration for such value that rightfully belongs to unsecured creditors.

6. Notwithstanding this Court's mandate that the Debtors run a sale process to determine what transaction or series of transactions would garner the most value for these estates, the only process the Debtors ran was to compare successive ESL bids to their own hypothetical and conservative wind-down estimates. As a result, and unsurprisingly, without consulting the Creditors' Committee in connection with making their final determinations, the Debtors and the Restructuring Subcommittee accepted the ESL Bid—a bid that (i) is the result of a flawed process, (ii) fails to provide value for unencumbered assets by a dramatic margin, (iii) will render the Debtors administratively insolvent, (iv) is premised on an inappropriate credit bid of disputed claims, (v) releases causes of action worth hundreds of millions of dollars and, importantly and (vi) is based on an unrealistic business plan that, if approved by this Court, will forestall for only a short period of time the inevitable liquidation of Sears and the cessation of the

45,000 jobs that Sears and ESL assert will be saved in connection with the ESL Sale. Indeed, approval of the ESL Sale is the likely precursor of yet another retail "chapter 22" case.

7. In seeking approval of the ESL Sale, the Debtors bear the burden of demonstrating to this Court not only that selection of the ESL Bid reflects an appropriate exercise of their business judgment, but also that the ESL Sale has been proposed in good faith and is "entirely fair" under the heightened scrutiny standard that must be applied to this insider transaction. The Debtors' decision to select ESL as the successful bidder notwithstanding their significant (and unresolved) administrative solvency concerns, exacerbated by the myriad deficiencies in the ESL Bid discussed herein, neither withstands heightened scrutiny nor supports a sound exercise of the Debtors' business judgment.

8. ***First***, although the Debtors and ESL tout the ESL Sale as a "going concern" transaction that "would preserve 45,000 jobs,"[5] this Court, unfortunately cannot take any comfort in such an assertion. The business plan upon which the ESL Sale is premised (the "ESL Business Plan") assumes—without adequate (if any) support—that the same insiders that drove Sears into bankruptcy can "transform" the enterprise through unprecedented and unsubstantiated growth rates and with razor thin liquidity. The ESL Business Plan assumes that, notwithstanding its near decade-long decline, the post-sale enterprise ("Sears NewCo") will emerge and begin growing revenue, growing EBITDAP[6] and growing margins, all while cutting corporate SG&A expenses, [redacted] within a year of closing. The ESL Business Plan predicts that same store sales will [redacted] in 2019—[redacted]—and then

[5] *See* Press Release, Sears Holdings Corporation, Sears Holdings Announces ESL Investments as Winning Bidder in Bankruptcy Court-Supervised Auction (Jan. 17, 2019) (the "ESL Sale Press Release"); ESL Partners, L.P., Beneficial Ownership Report (Schedule 13-D) (Jan. 18, 2019), Item 4.

[6] "EBITDAP" means earnings before interest, taxes, depreciation, amortization, and pension.

simply predicts that those sales will [redacted]. The ESL Business Plan also anticipates that EBITDAP margins will immediately [redacted]. For its stores, as well as for Sears Auto Centers, the ESL Business Plan forecasts a [redacted]. While Sears has not generated positive EBITDAP since 2012, the ESL Business Plan assumes that Sears NewCo will immediately [redacted]. None of the speculative initiatives contained in the ESL Business Plan, however, suggest that Sears's historical inability to achieve sales and profitability targets will suddenly abate.

9. With the fanciful ESL Business Plan that disregards historical financials and the reality of the current retail environment, Sears NewCo is destined to follow the same downward trajectory. When Sears NewCo inevitably runs into financial distress in the near future, the Debtors' creditors—whose claims purportedly are being assumed by Sears NewCo's holding company—will bear the brunt, once again. And ESL's promises of continued employment for tens of thousands of Sears's employees necessarily will vaporize. Indeed, although the ESL Bid contemplates offers of employment to 45,000 current Sears employees, there is no restriction on Buyer's ability to terminate such employees immediately thereafter. [redacted]. *See* Transcript of Robert Riecker, dated January 25, 2019 (the "Riecker Transcript") 140:25-142:19, [redacted] Given Sears's historical performance with ESL and Lampert at the helm, it strains credulity that the ESL Sale will result in a viable go-forward enterprise.

Instead, the ESL Sale will authorize ESL to leverage these Chapter 11 Cases to conduct its own GOB process for its sole benefit, while freeing Sears NewCo from towering liabilities and offering only limited benefits to the Debtors' estates and creditors. Even before the ESL Business Plan is proven wrong with actual results, under the terms of the APA, ESL will begin liquidating the assets being acquired. For example, the APA provides Buyer with the right, for up to 60 days following the Closing Date, to conduct an extended marketing process for the sale of the Debtors' executory contracts and leases of non-residential real property to third parties, with the proceeds of such sales to inure solely to ESL's benefit.[7] *See* APA §§ 2.7(c) and (d), 2.9, 5.2. Moreover, ESL's President testified, and the ESL Business Plan assumes, [redacted] *See* Transcript of Kunal Kamlani, dated January 24, 2019 (the "Kamlani Transcript") 116:14-121:11.

10. ***Second***, the ESL Sale will, [redacted], render the estates administratively insolvent. While ESL pays lip service to solving for the payment in full of administrative liabilities, the proposed consideration in the ESL Sale [redacted]. Indeed, Buyer's obligation under the APA to pay approximately $667 million in assumed administrative liabilities is nothing more than a contingent reimbursement obligation, the sole remedy for which is a general unsecured claim in favor of the Debtors against Buyer, a newly created ESL shell entity whose only value is tethered to a sinking ship without a viable go-forward strategy. *See* APA § 2.3(k)(x); Proposed Sale Order, attached as Ex. B to the Sale Notice, ¶ 25. Without a viable business plan to support the

[7] Remarkably (but perhaps not surprisingly), the Creditors' Committee was unsuccessful in its strident efforts to compel the Debtors to conduct such a marketing process for the benefit of these estates, which the Debtors' repeatedly refused.

ESL Bid, there can be no expectation that Sears NewCo will have the financial wherewithal to remain in business or that assumed liabilities will be satisfied on a go forward basis. Based on the Creditors' Committee's analysis of ESL's proposed financing and the ESL Business Plan, Sears NewCo likely will be in financial distress in a matter of months. And, by design, the third-party creditors whose claims are being "assumed" will have no recourse.

11. The ESL Sale also contemplates numerous other administrative expenses that will deepen the Debtors' administrative insolvency and cause the Debtors to bear significant credit risk in respect of Sears NewCo. These expenses result from, among other things: (i) royalty payment obligations in connection with intellectual property owned by non-Debtor KCD IP, LLC;[8] (ii) ongoing administrative expenses incurred by the Debtors following closing of the APA (and as required under the APA) on account of assets sold to Buyer; (iii) [redacted] professional fees including in connection with the prosecution of the ESL Sale and the extended post-Closing period during which the Debtors are required to provide services to Buyer under the APA; and (iv) numerous potential reductions of assumed liabilities.

12. Moreover, the proposed ESL Sale is fraught with execution risk because of the highly conditional nature of ESL's obligation to close. Specifically, the APA contains numerous closing conditions that are outside of the Debtors' control, certain of which may result in an inability to close the transaction (and the return of ESL's $120 million deposit).

- **Sale of Non-Debtor Assets.** The APA provides for the sale of assets by non-Debtors to Buyer or otherwise makes the assumption of certain liabilities contingent on such non-Debtor asset sales, including, among other things, the

[8] The indenture trustee for the KCD Notes (as defined below) has asserted that royalty payments obligations are due and owing. While the Creditors' Committee continues to evaluate the propriety of such assertion, [redacted]

KCD Notes[9] and intellectual property owned by KCD IP, LLC. *See* APA § 2.1(e), (r).

- **Completion of Marketing Period for ESL's Financing.** The APA provides that the Closing is conditioned upon expiration of a marketing period for Buyer's financing. *See id.* § 4.1. If the marketing period is interrupted and the Closing is delayed, the Closing may not occur before the Outside Date, and in turn, Buyer would have a right to terminate the APA and receive a refund of its $120 million deposit.

- **Value of Acquired Assets/Maximum Liabilities.** The APA sets forth numerous conditions to Buyer's obligation to close that give Buyer significant leeway to walk away from the transaction without recourse (and with a refund of its $120 million deposit), including, most significantly: (i) the aggregate value of the acquired inventory and accounts receivable must be at least $1.657 billion; (ii) the outstanding indebtedness under the DIP ABL Facility shall be no greater than $850 million; and (iii) the outstanding indebtedness under the Junior DIP Facility shall be no greater than $350 million. Sellers' projections indicate that it will be a challenge for them to meet these inventory and receivables thresholds as well as the DIP balance thresholds. *See id.* §§ 10.9, 10.10.

- **Milestones.** Buyer can terminate the APA and receive a refund of its $120 million deposit in the following circumstances, among others: (i) the ESL Sale has not closed by February 19, 2019 (*see id.* § 12.1(a)(ii)); or (ii) the Court has not approved the transactions or the Approval Order is not obtained (or is vacated or stayed) by February 8, 2019 (*see id.* § 12.1(b)(ii)).

13. Left with insufficient assets to satisfy the claims that will be left in its wake, the ESL Sale all but guarantees administrative insolvency for the Debtors.

14. ***Third***, ESL accomplishes its feat of exchanging $35 million in cash for (i) allowance of all the ESL Claims and (ii) a broad release of valuable estate causes of action to enable it to submit an inappropriate and impermissible credit bid. The credit bid, however, is premised on disputed claims in contravention of applicable law and, moreover, cannot credibly be offered as consideration for the purchase of the Debtors' unencumbered assets. By the Debtors' own estimates, [redacted] of unencumbered value exists in the estates—

[9] "KCD Notes" means the 6.90% KCD IP, LLC Asset-Backed Notes issued pursuant to the Indenture dated as of May 18, 2006, by non-Debtor KCD IP, LLC as Issuer and U.S. Bank National Association as Trustee. APA § 1.1.

including valuable business segments and [redacted] real estate assets. Yet, ESL has refused to allocate its purchase price, as expressly required under the Global Bidding Procedures. Therefore, it is impossible to know what value (if any) ESL is ascribing to the acquisition of the Debtors' unencumbered assets. By the Creditors' Committee's estimates, however, the purchase price paid in connection with the ESL Sale undervalues the Debtors' unencumbered assets by up to [redacted]. ESL surely will contend that Buyer's agreement to assume certain of the Debtors' administrative liabilities is in consideration for the unencumbered assets, but even if the obligation to assume liabilities were ironclad and not illusory, the magnitude of the value of the unencumbered assets to be acquired vastly exceeds the extent of the assumed administrative liabilities.

15. In addition, the claims that ESL purports to credit bid are vigorously contested by the Creditors' Committee, as evidenced by the ESL Claims Objection filed contemporaneously herewith and the Standing Motion and Proposed Complaint filed previously with this Court. By the Standing Motion, the Creditors' Committee seeks standing to pursue certain claims and causes of action against ESL, including avoidance actions, recharacterization claims and equitable subordination claims. For the reasons discussed herein and set forth in the Standing Motion, the Proposed Complaint and the ESL Claims Objection, these causes of action are colorable and viable and, therefore, subject ESL's claims, and thus its right to credit bid, to legitimate dispute. Yet, to date, ESL has been unwilling to cash collateralize its bid despite the Court's clear instruction to do so in the event legitimate disputes arise. The ESL Sale also contemplates allowance of all of the ESL Claims aggregating approximately $2 billion, which vastly exceed the claims ESL intends to credit bid. In the unlikely event that ESL is permitted to credit bid at all, the ESL Claims should be allowed solely for that limited purpose and without

limiting remedies that otherwise would be available to the Debtors' estates upon successful prosecution of the causes of action referenced in the Standing Motion, Proposed Complaint and ESL Claims Objection.

16. ***Fourth***, all evidence, [redacted], indicates that the value-maximizing path for these Chapter 11 Cases is an orderly sum of the parts sale process and a contemporaneous GOB process run by the Debtors. A properly conducted wind-down process will yield higher and better results than the ESL Sale, which will, in turn, enable the Debtors to distribute to their unsecured and true third-party creditors the value to which such creditors are entitled. And such process would not include the inappropriate release in favor of ESL or permission for ESL to credit bid disputed claims. The Debtors, who up until the very last minute were in agreement that a wind-down was the value maximizing path, relied on a number of dubious assumptions, as well as a deeply flawed marketing and auction process, in justifying their ultimate decision to seek approval of the ESL Sale—again, a decision made without consulting with the Creditors' Committee.

17. In short, the Debtors seek approval of a highly questionable transaction representing a Hail Mary for their controlling insider that (i) places massive risk on the Debtors' unsecured creditors and leaves them with nothing but up to $35 million in cash and limited preserved causes of action, (ii) results in administrative insolvency, (iii) is premised on an unsupportable business plan and (iv) requires the release of colorable and valuable causes of action. And the Debtors endeavor to proceed with the ESL Sale notwithstanding the availability of a value-maximizing alternative in the form of GOB sales that would, at worst, leave the Debtors administratively solvent and, at best, provide hundreds of millions of dollars in recoveries to unsecured creditors. The Creditors' Committee has communicated repeatedly to

the Debtors, the Restructuring Subcommittee and their various professionals that despite its shared desire to preserve the Sears enterprise and save jobs, there are incurable deficiencies in the ESL Bid. Such concerns were disregarded and, consequently, the Debtors' pursuit of the ESL Sale raises serious questions as to the Debtors' exercise of their fiduciary duties in determining the ESL Sale was in the best interests of the Debtors' estates.

18. The ESL Sale does not comport with a sound exercise of the Debtors' business judgment, let alone the heightened scrutiny that must be applied in connection with this insider transaction. Indeed, even absent the broad release and inappropriate credit bid provided to ESL in connection with the transaction, the ESL Sale falls woefully short of satisfying the applicable legal standards. Against this backdrop, the Court should put an end to the pretense of a "going concern" bid by ESL and deny the ESL Sale in its entirety as not in the best interests of the Debtors' estates.

BACKGROUND

I. GENERAL BACKGROUND

A. Chapter 11 Cases

19. On October 15, 2018 (the "Petition Date")[10] and continuing thereafter, each of the Debtors filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). The Debtors continue to operate their businesses as debtors in possession pursuant to Bankruptcy Code sections 1107 and 1108. No request has been made for the appointment of a trustee or an examiner.

[10] Capitalized terms used and not otherwise defined herein shall have the meanings ascribed to such terms in the Asset Purchase Agreement, dated as of January 17, 2019, by and among Transform Holdco LLC, Sears Holdings Corporation and its subsidiaries party thereto (the "APA"), attached as Exhibit B to the *Notice of Successful Bidder and Sale Hearing*, dated January 18, 2019 [ECF No. 1730] (the "Sale Notice").

20. On October 24, 2018, the United States Trustee for the Southern District of New York (the "U.S. Trustee") appointed the Creditors' Committee pursuant to Bankruptcy Code section 1102 [ECF No. 276].[11]

B. Prepetition Capital Structure

21. As of the Petition Date, the Debtors had outstanding obligations under the following facilities: (i) First Lien Credit Facility; (ii) Stand-Alone L/C Facility; (iii) Second Lien Credit Facility; (iv) Second Lien PIK Notes; (v) Second Lien Notes; (vi) IP/Ground Lease Term Loan; (vii) Consolidated Secured Loan Facility; (viii) Holdings Unsecured PIK Notes; (ix) Holdings Unsecured Notes; (x) SRAC Unsecured PIK Notes; and (xi) SRAC Unsecured Notes. *See Declaration of Robert A. Riecker Pursuant to Rule 1007-2 of Local Bankruptcy Rules for Southern District of New York*, dated October 15, 2018 [ECF No. 3] (the "First Day Decl.") ¶ 34.[12] The Debtors' prepetition capital structure, along with the percentage of each facility held by ESL is set forth below.

[11] The Creditors' Committee currently comprises: (i) Apex Tool Group, LLC; (ii) Brixmor Operating Partnership, L.P.; (iii) Computershare Trust Company, N.A., as indenture trustee; (iv) Oswaldo Cruz; (v) Pension Benefit Guaranty Corporation; (vi) Simon Property Group L.P.; (vii) The Bank of New York Mellon Trust Company, N.A., as indenture trustee; and (viii) Winiadaewoo Electronics America, Inc.

[12] Each credit facility discussed herein shall have the meaning ascribed to such term in the First Day Decl.

Debt Facilities *(As of Petition Date)*	**Principal Outstanding ($mm)**	**ESL Amount Owned (%)**	**ESL Amount Owned ($mm)**
Revolving Credit Facility	$836.0	0%	-
First Lien Letters of Credit	123.8	0%	-
First Lien Term Loan B	570.8	0%	-
FILO Term Loan	125.0	56%	70.6
Total First Lien Debt	**$1,655.6**	**4%**	**$70.6**
Stand-Alone L/C Facility	**$271.1**	**40%**	**$108.4**
Second Lien Term Loan	317.1	100%	318.6
Second Lien Line of Credit	525.0	97%	507.1
Alternative Tranche Line of Credit Loans	45.0	0%	-
Second Lien PIK Notes	175.4	12%	21.3
Second Lien Notes	89.0	0%	-
Total Second Lien Debt	**$1,151.5**	**74%**	**$847.0**
IP/Ground Lease Term Loan	231.2	81%	187.3
Consolidated Secured Note A	108.1	0%	-
Consolidated Secured Note B	723.3	100%	726.5
Total Secured Loan Debt	**$1,062.6**	**86%**	**$913.8**
Holdings Unsecured PIK Notes	222.6	88%	195.9
Holdings Unsecured Notes	411.0	0%	-
SRAC Unsecured PIK Notes	107.9	0%	-
SRAC Unsecured Notes	185.6	0%	-
Total Unsecured Debt	**$927.1**	**21%**	**$195.9**
Total Funded Debt	**$5,067.9**	**42%**	**$2,135.7**

II. THE CREDITORS' COMMITTEE'S INVESTIGATION UNCOVERS VIABLE AND VALUABLE CLAIMS AND CAUSES OF ACTION AGAINST ESL AND LAMPERT

A. The Creditors' Committee Investigates the Debtors' Prepetition Transactions

22. Since its appointment, the Creditors' Committee has worked tirelessly to conduct an independent investigation into the Debtors' prepetition transactions to determine whether claims exist that may return value to the Debtors' estates. On November 16, 2018, the Court entered the *Order Pursuant to Bankruptcy Code Section 105 and Federal Rules of Bankruptcy Procedure 2004, 9006, and 9016 Authorizing Expedited Discovery of the Debtors and Third Parties* [ECF No. 802], which authorized the Creditors' Committee to conduct oral examinations of the Debtors and other third parties and issue subpoenas for the production of documents relevant to certain prepetition transactions (the "Investigation").

23. The Creditors' Committee undertook this Investigation on an extremely compressed timeframe, reviewing approximately 130,000 documents from, and interviewing representatives of, the Debtors, ESL and various third parties. Through its Investigation, the Creditors' Committee uncovered substantial evidence that Lampert and ESL have acted with methodical precision for more than a decade to enrich themselves at Sears's expense, secure control over Sears's best assets and attempt to shield such assets from the reach of other creditors.

B. The Creditors' Committee Files the Standing Motion To Assert Claims of the Debtors' Estates Arising from ESL's and Lampert's Scheme to Destroy Sears for ESL's Benefit

24. On January 24, 2019, the Creditors' Committee filed the Standing Motion and Proposed Complaint. Through the Standing Motion and the 109-page Proposed Complaint, the Creditors' Committee set forth detailed factual support for numerous viable causes of action the Debtors' estates possess against ESL, Lampert and Kunal Kamlani ("Kamlani") arising from ESL's and Lampert's decade-long scheme to strip Sears's assets, including claims for recharacterization, equitable subordination, actual and constructive fraudulent transfer, breach of fiduciary duty and unjust enrichment. A brief overview of the facts discussed at length in the Standing Motion and Proposed Complaint follow.

1. ESL's Investment: Lampert and ESL Acquire Kmart and Sears Roebuck, Which Became ESL's Central Investments

25. Lampert is—or at least once was—a celebrated investor. He operates his namesake hedge fund—ESL—more like a private equity firm, taking a significant position in a few companies, acquiring a controlling stake in those companies, and then working closely with the companies' management or board of directors to drive results and value back to ESL.

Lampert and ESL used this private equity approach in its take-over and management of Kmart Corporation ("Kmart") and, eventually, Sears.

26. In May 2003 Kmart emerged from bankruptcy with Lampert and ESL as its largest shareholder.[13] Rumor on Wall Street had it that "Lampert planned to milk the company for cash, using Kmart's real estate as his secret cache."[14]

27. In June 2004, Kmart announced the sale of 51 stores to Sears, Roebuck and Co. ("Sears Roebuck") for $605 million in cash, a figure so unexpectedly high that by November 2004, Kmart's stock traded at eight times its price when Kmart first emerged from bankruptcy, for reasons largely tied to the estimated value of Kmart's real estate. ESL pivoted and used Kmart's inflated market capitalization to acquire Sears Roebuck, merging the companies in 2005 under a new parent entity, Sears Holdings Corporation (the "Kmart-Sears Roebuck Merger"). Commentators noted that Lampert—who was known for investing wizardry but not for retail experience—was interested in Sears Roebuck primarily for its valuable real estate portfolio (much as he was rumored to be for Kmart).

28. ESL and Sears became intrinsically inseparable. After the Kmart-Sears Roebuck Merger, Lampert became Chairman of the Board of Holdings (the "Board") and obtained authority from the Board to direct investment of surplus cash.[15] Lampert and ESL initially owned 41 percent of Sears's outstanding common stock, but their stake soon grew to 54.1 percent by January 2009 and peaked at 62.0 percent in January 2012. On information and belief,

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[13] Riva D. Atlas, *Its Stock Up, Sears Searches for Recovery*, N.Y. TIMES (Aug. 2, 2005), https://www nytimes.com/ 2005/08/02/business/its-stock-up-sears-searches-for-recovery.html.

[14] *See* Patricia Sellers, *Eddie Lampert: The best investor of his generation*, FORTUNE MAGAZINE (Feb. 6, 2006), https://money.cnn.com/2006/02/03/news/companies/investorsguide_lampert/.

[15] Sears Holdings Corp., Annual Report (Form 10-K), at 92 (Mar. 17, 2006).

Sears and Sears-related businesses have comprised the core investments of ESL's portfolio since 2005.

2. The Stock Buy-Backs: Under Lampert's Direction, Sears Spent Its Cash for ESL's Short-Term Benefit and to the Detriment of Sears's Long-Term Prospects

29. With a controlling stake in the combined enterprise, and with the Board's delegation to Lampert of investment decisions regarding the surplus cash, Lampert and ESL set about lowering capital expenditures, drastically cutting investment in Sears's businesses and funneling cash into a stock repurchase program. By reducing the number of outstanding shares and thereby increasing earnings-per-share, price-to-earnings ratio and return on equity metrics, the aggressive buybacks had the instant effect of artificially boosting the stock price to a peak of approximately triple its price at the time of the Kmart-Sears Roebuck Merger. From 2005 to 2008, Sears spent an estimated $6 billion—the majority of its cash—on stock repurchases, with some repurchases made at prices as high as $180 per share.[16] Lampert's and ESL's motive was simple: they increased their ownership percentage by reducing the number of outstanding shares in the market and raked in astronomical investment fees from the fund's investors as a function of the rising stock price. One commentator recently calculated that ESL earned an estimated ***$1.9 billion*** during the ascent of Sears's stock in 2006 alone, based on an estimated 20 percent performance fee charged to ESL's investors.[17]

30. By using the majority of its cash to repurchase stock, Sears grossly underinvested in its businesses and lagged behind its peers during a time of intense secular competition. In

[16] Suzanne Kapner, *Inside the Decline of Sears, the Amazon of the 20th Century*, WALL STREET JOURNAL (Oct. 31, 2017), https://www.wsj.com/articles/inside-the-decline-of-sears-the-amazon-of-the-20th-century-1509472095.

[17] Michelle Celarier, *Eddie Lampert Shattered Sears, Sullied His Reputation, and Lost Billions of Dollars. Or Did He?*, INSTITUTIONAL INVESTOR (Dec. 3, 2018), https://www.institutionalinvestor.com/article/b1c33fqdnhf21s/Eddie-Lampert-Shattered-Sears-Sullied-His-Reputation-and-Lost-Billions-of-Dollars-Or-Did-He.

2004 alone, Sears Roebuck and Kmart managers spent a total of $1.1 billion on various reinvestments, including renovations and new-store openings. Under ESL's direction, that number dropped to just $546 million in 2005 and $513 million in 2006.[18] The difference quickly became apparent to commentators at the time: Sears's stores featured empty shelves and out-of-date merchandise and looked "shabby next to those of rivals like Target and J.C. Penney."[19] Against the backdrop of consumer belt-tightening during the financial crisis and ensuing recession, Sears's bottom line fell deeply in the red, even while competitors such as Walmart, Costco and Target thrived.

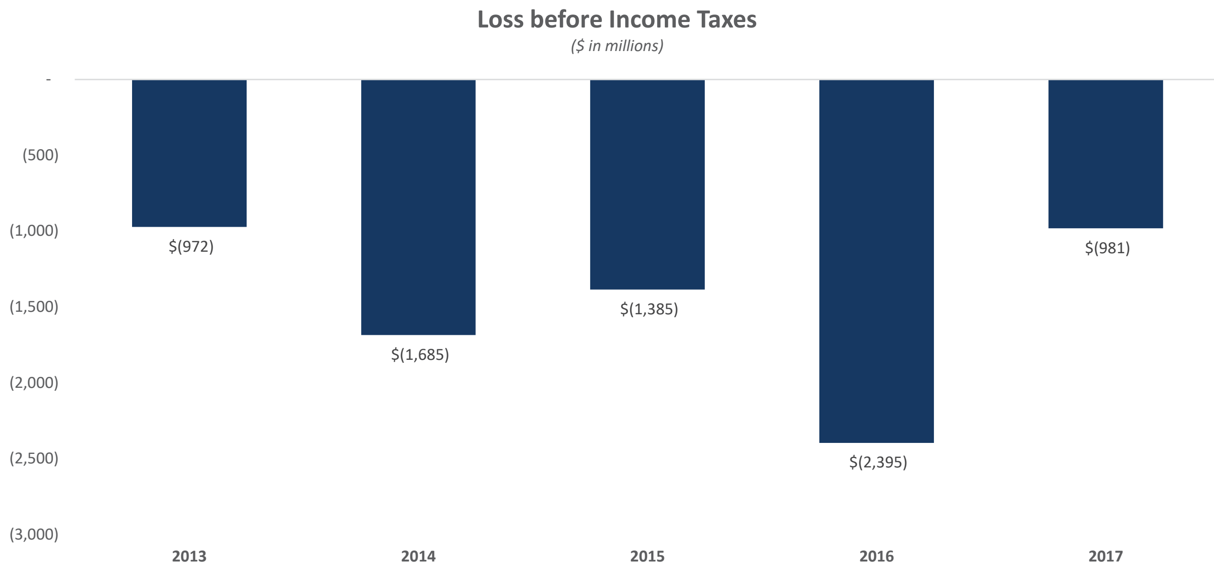
31. Despite the worsening outlook for the retail industry and Sears, Lampert and ESL consistently set overly optimistic but inaccurate financial projections for Sears's management. Every year, as part of an annual budgeting process, individual business units at Sears would set forth internal revenue and cost goals they viewed as attainable for the coming year. And each year, Lampert and ESL effectively would ignore this bottom-up approach by management, instead setting a purely aspirational top-down financial projection—which was based on little more than Lampert's desire to achieve "best in class" results—that was then folded into Sears's Annual Plan. These projections essentially would consist of a target EBITDAP for which returns would look favorable to investors. The individual business units were then pressured to try to fill the gap between their own targets and those set by Lampert and ESL. They invariably failed to do so. Rather than lower the Lampert/ESL-imposed top-down projections, Sears instead would assume that the gap would be filled by "unidentified initiatives" or, in Lampert's own words, "go

[18] Gretchen Morgenson, *et al.*, *Saving Sears Doesn't Look Easy Anymore*, N.Y. TIMES (Jan. 27, 2008), https://www.nytimes.com/2008/01/27/business/27eddie html.

[19] *Id.*

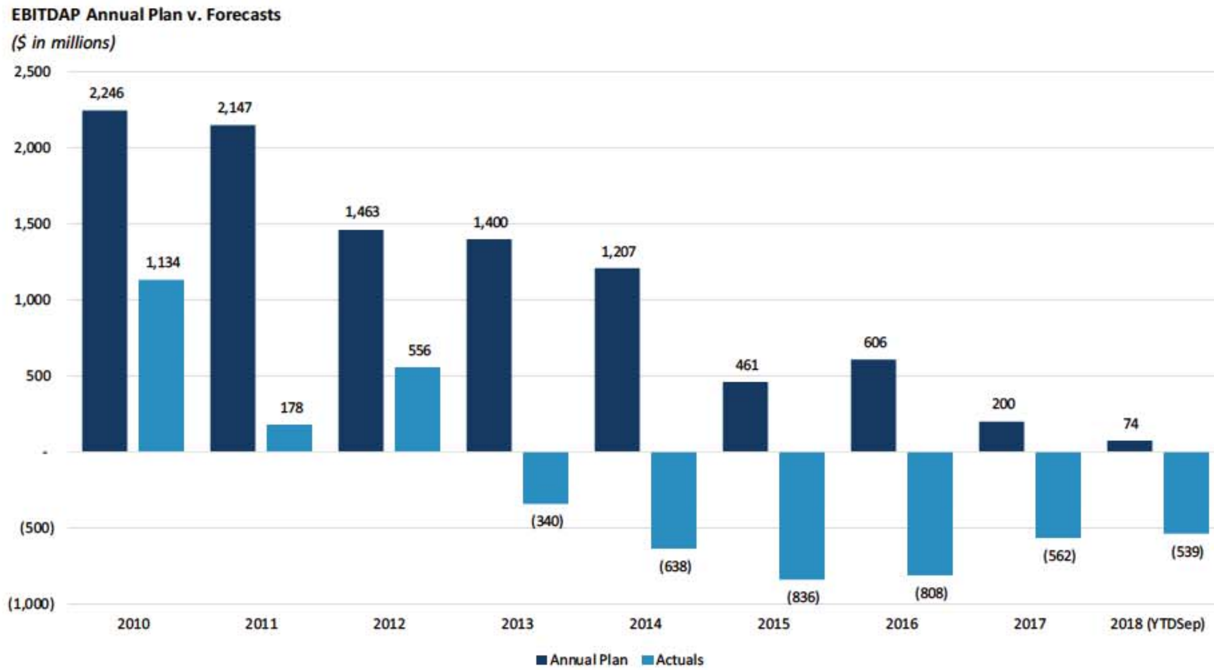
gets." Simply put, not only was there no achievable plan in place, often times there was no plan at all.[20]

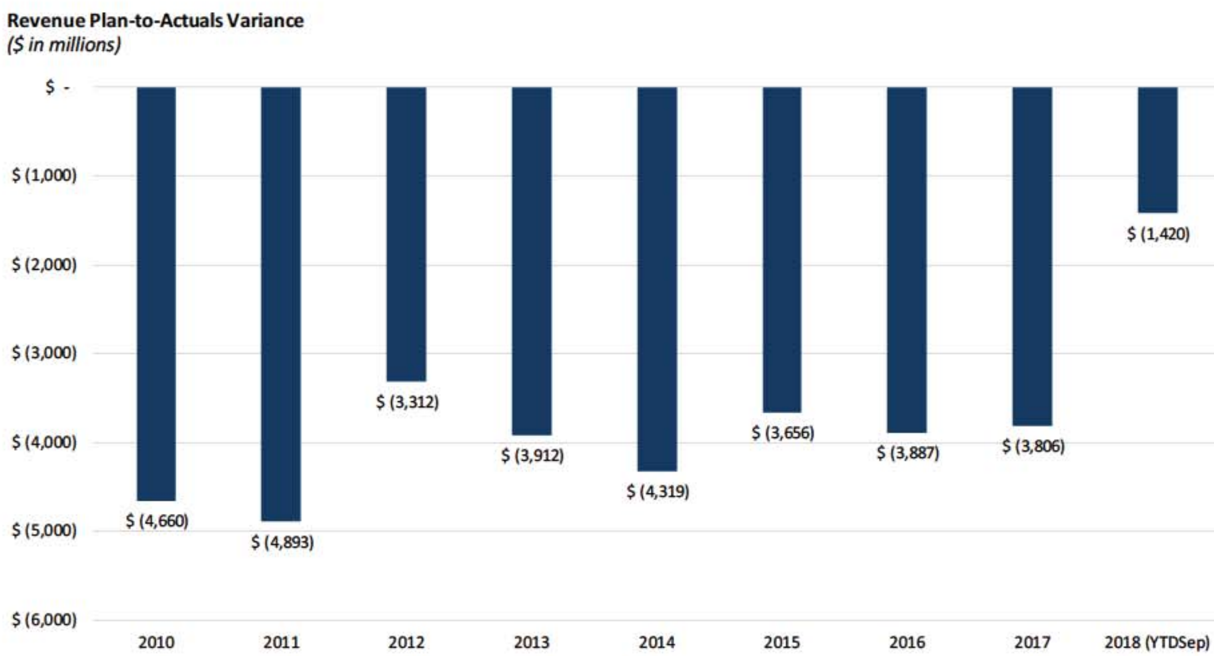
32. Indeed, since Lampert's reign as CEO began in 2013, Sears lost billions of dollars, as shown in the below chart.



33. Despite these consistent losses, each of Sears's annual projections forecasted *positive* EBITDAP of hundreds of millions of dollars. Lampert and ESL essentially projected, year after year, a dramatic turnaround—typically based on vague initiatives related to an explosion in the popularity of Sears's loyalty platform, Shop Your Way—and year after year, Sears missed the Lampert/ESL target EBITDAP (and in fact has not attained positive EBITDAP since 2013). The following charts illustrate how divorced from reality those projections were:

[20] The expert report of Jan Kniffen, the Creditors' Committee's retained expert concerning retail strategies and business planning, contains a detailed discussion on Sears's inaccurate projections and unreasonable business strategies. *See generally* Expert Report of Jan R. Kniffen (the "Kniffen Report"), attached hereto as **Exhibit C**, Parts III.C.iv, IV.D-E.





34. Lampert's and ESL's influence on Sears extended beyond the mythical projections to Sears's very corporate structure and culture because of active involvement—through Lampert—in Sears's management and operations.

35. Within just a few years after the Kmart-Sears Roebuck Merger, Lampert and ESL had solidified control over the Company, fragmented it into rival business units that competed for scarcer and scarcer resources and set forth unreachable projections while Sears's bottom line declined rapidly.

3. The Spin-Offs: With Cash Dwindling, ESL Takes Control of Sears's Desirable Business Units for ESL's Direct Benefit

36. With Lampert and ESL in control and Sears's cash position deteriorating, Lampert, ever the financial engineer, directed Sears to spin off its most valuable assets in what amounted to a slow motion, out-of-court liquidation, with ESL being the glad recipient of such assets for no or inadequate consideration. The stated reasons for the spin-offs were to improve liquidity or promote operational flexibility. In reality, however, Lampert and ESL directly benefited on both sides of each transaction, acquiring control of spun-off assets while often receiving dividends as Sears's controlling shareholder. All this was to the detriment of Sears and its creditors.

37. Beginning in 2011, Lampert and ESL orchestrated the spin-off of some of Sears's most productive and valuable assets for their direct benefit. A prime example: in 2014, Sears spun off the desirable Lands' End business (which had reported $150 million of adjusted EBITDA for 2013) in a tax-free, pro rata distribution that generated only a $500 million cash dividend for Sears—far short of its $1.4 billion to $1.5 billion enterprise valuation based on available market indicators. Within one year of the spin-off, ESL's stake in Lands' End—a stake that ESL had acquired free of cost—had nearly doubled in value to almost $852 million. Meanwhile, Sears began reporting negative EBITDAP every year since 2013, having been insolvent at the time of (or rendered insolvent by) the Lands' End spin-off.

38. Each spin-off or rights offering generated immediate profits or benefits for Lampert and ESL and dealt blow after blow to an already reeling Sears. By the end of 2014, Sears was a shell of its former self. In 2011, Sears had 4,010 total stores—a number that had fallen to 1,725 by the end of 2014.[21] And as of January 29, 2011, Sears had approximately 312,000 employees,[22] compared with only 196,000 employees by January 31, 2015.[23] As of the Petition Date, that number had fallen to approximately 68,000. First Day Decl. ¶ 8.

39. By the end of 2014, Sears's equity book value had dropped to nearly negative $1 billion and, net of goodwill and intangibles, to below negative $3 billion. Meanwhile—in what hardly can be described as a coincidence—ESL's equity stake had also dropped in 2013 to below 50 percent from a high of 62.0 percent in January 2012 and its equity stake in the spun-off entities had generally increased.

40. Simply put, from 2011 until 2015, Lampert and ESL spun off Sears's most valuable assets, retained control over those assets while ostensibly shielding them from the reach of Sears's creditors, and obtained direct benefits from the spin-offs (including from dividend payments). At the same time, Lampert and ESL reduced their equity ownership of a reeling Sears enterprise while retaining a controlling stake. They acted as expected: these spin-offs had crippled Sears's long-term prospects but lined Lampert's and ESL's pockets.

4. The Real Estate Play: Lampert and ESL Secure for Their Own Benefit Sears's Remaining Valuable Assets—Prime Real Estate—From an Insolvent Sears

41. In 2015, Lampert's and ESL's self-serving asset stripping and wind-down scored the biggest prize yet: a commanding portion of Sears's most valuable remaining real estate.

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[21] *Compare* Sears Holdings Corp., Annual Report (Form 10-K), at 2 (Mar. 14, 2012) *with* Sears Holdings Corp., Annual Report (Form 10-K), at 2 (Mar. 17, 2015).

[22] Sears Holdings Corp., Annual Report (Form 10-K), at 5 (Mar. 11, 2011).

[23] Sears Holdings Corp., Annual Report (Form 10-K), at 6 (Mar. 17, 2015).

ESL and Lampert, who had long been interested in Sears primarily for its real estate portfolio, engineered a sale-leaseback involving 266 of Sears's properties, many of which were among Sears's best remaining real estate assets (the "Seritage Transaction"). ESL became the beneficial owner of many of Sears's most valuable real estate properties for a price that was hundreds of millions of dollars short of reasonably equivalent value—the kind of price available only to a self-dealing insider acting on both sides of the transaction. At the time of the Seritage Transaction, Sears was hopelessly insolvent; if not, the Seritage Transaction certainly made it so. And since the Seritage Transaction closed, Lampert and ESL have intentionally kept Sears afloat—risking little because of the security obtained for the continuous capital injections—to mask the Company's insolvency and delay its unavoidable bankruptcy in order to prop up the stock price of Seritage Growth Properties ("Seritage") for ESL's benefit.

42. The Seritage Transaction was an insider deal conceived and driven by Lampert and ESL that was neither negotiated at arm's length nor exposed to the market—and it showed. The $2.7 billion in aggregate consideration provided to Sears was an absurdly low purchase price, which the market recognized, based on rights trading prices before the transaction and stock prices afterward. As detailed in the Proposed Complaint, this below-market purchase price was caused, in part, by Cushman & Wakefield Inc.'s ("Cushman & Wakefield") flawed appraisals that greatly undervalued the properties' fair market value.

43. The purchase price did not take into account the highest and best use of the properties—many of which were among Sears's most valuable properties—and was instead predicated on Sears remaining a tenant and paying discounted rent indefinitely (discounted to account for disadvantageous lease terms, not because the rate was a bargain). But Seritage, Lampert and ESL have not hesitated to make the best use of the transferred Seritage assets.

Indeed, Seritage has since thrived at recapturing, redeveloping and re-leasing space at many multiples of the rent Sears was paying and has attracted new marquee investors including Warren Buffett—all while Sears fell even deeper into insolvency.

44. The Board's Related Party Transactions Subcommittee ("RPT Subcommittee")—tasked with scrutinizing conflicted transactions—was not an adequate check on ESL's power and control. The RPT Subcommittee merely rubber-stamped the Seritage Transaction and failed to consider the fairness of the deal to Sears or its implications for Sears's creditors.

5. The Capital Contributions: ESL "Finances" Sears To Protect Its Investments, Lien Up Remaining Assets and Solidify Sears's Fate

45. The Seritage Transaction marked a turning point in Sears's demise. With Sears in a freefall and its eventual bankruptcy a question of when, rather than if, Sears was desperate for cash—and ESL was always there. Sears, for the most part, never even bothered to seek financings from third-party creditors on the open market because ESL always was prepared to contribute capital—and happily so, being motivated to encumber previously unencumbered assets, buy time needed to maximize and protect its investments in Sears, and protect its equity interest in Seritage that remained dependent on Sears. Under the guise of assisting Sears with its liquidity needs, ESL had free reign to secure remaining assets and wall off other creditors in inevitable bankruptcy proceedings.

46. ESL's numerous further investments in Sears—papered as debt but playing the role of equity—in the period since the Seritage Transaction include: the 2016 Term Loan, Second Lien Term Loan, Stand-Alone L/C Facility, Second Lien Line of Credit, IP/Ground Lease Term Loan, FILO Term Loan and Consolidated Secured Loan Facility (which resulted from the consolidation of obligations under the 2016 Real Estate Secured Loan and 2017 Real

Estate Secured Loan, and the termination of the former loan) (together, the "2016-2018 ESL Contributions").

47. Although the 2016-2018 ESL Contributions ostensibly were debt financings, ESL did not intend to provide Sears with liquidity. Rather, they were attempts essentially to purchase Sears's remaining capital assets through a series of liens in preparation for the imminent bankruptcy filing and to keep Sears alive long enough for the Seritage operation to take flight. Thus, it was no surprise that ESL submitted a bid (a completely nonactionable bid) in these Chapter 11 Cases to acquire Sears using, in large part, a credit bid of the "debt" held by ESL. That "debt" bore the hallmarks of equity contributions and not debt for the reasons discussed in detail in the Standing Motion and Proposed Complaint.

C. The Estates' Claims Against Lampert, ESL and Kamlani

48. Lampert and ESL, aware for years that bankruptcy proceedings were inevitable, forced Sears to undergo spin-offs, rights offerings and financings all for Lampert's and ESL's benefit while Sears's net equity book value plunged in the years leading up to these Chapter 11 Cases. Lampert and ESL spent years as the master puppeteers preparing for these Chapter 11 Cases, using their undue influence over management and the Board to concoct transactions that would insulate and maximize the value of ESL's Sears-related investments—including through financings disguised as debt that have the characteristics of equity—from the adverse effects of Lampert's and ESL's unparalleled siphoning of Sears's best assets for their own benefit. Indeed, Lampert's and ESL's long, drawn-out scheme had the effect of ring fencing Sears's valuable assets for Lampert's and ESL's benefit with the clear objective of leaving little or nothing for the creditors that Lampert and ESL could orchestrate transactions around.

49. As set forth in the Standing Motion, Proposed Complaint and ESL Claims Objection, the Creditors' Committee has determined that the Debtors have viable claims to assert

against Lampert, ESL and Kamlani (ESL's President and a director of Holdings) to seek the following relief:

- recharacterization as equity of the 2016-2018 ESL Contributions;
- equitable subordination of ESL's Claims on account of Lampert's and ESL's inequitable conduct;
- recovery from Lampert and ESL of the value of the properties transferred in the Seritage Transaction and the Lands' End spin-off pursuant to Bankruptcy Code sections 544 and 550 and applicable state law;
- avoidance of the Lands' End spin-off as an actual and constructive fraudulent transfer pursuant to Bankruptcy Code section 544 and applicable state law;
- avoidance of the 2016-2018 ESL Contributions as actual fraudulent transfers pursuant to Bankruptcy Code sections 544 and 548 and applicable state law and recovery of payments made on account thereof;
- avoidance of grants and guarantees made by certain of Sears's subsidiaries in connection with the creation of the IP/Ground Lease Term Loan as constructive fraudulent transfers pursuant to Bankruptcy Code sections 544 and 548 and applicable state law;
- disallowance of all of ESL's Claims in these Chapter 11 Cases pursuant to section 502(d) of the Bankruptcy Code unless and until ESL returns the benefits it received because of the constructive and actual fraudulent transfers;
- recovery on account of unjust enrichment claims against Lampert and ESL in connection with the Lands' End spin-off, the Seritage Transaction and the 2016-2018 ESL Contributions; and
- recovery on account of breach of fiduciary duty and aiding and abetting breach of fiduciary duty claims against Lampert, ESL and Kamlani in connection with the 2016-2018 ESL Contributions.

D. The Debtors' Refusal to Assert the Proposed Claims

50. Aside from opting for a path forward that will leave their estates administratively insolvent, by selecting the ESL Sale, the Debtors have decided not to pursue any of the very valuable claims, including the claims underyling the Standing Motion and Proposed Complaint, against ESL, Lampert and Kamlani. The ESL Sale is dependent upon a credit bid of

approximately $1.3 billion of ESL's Claims. By allowing ESL to credit bid in exchange for paltry consideration of only $35 million, and accepting that credit bid, the Debtors are allowing ESL to realize the full secured value of the face amount of those disputed claims, which, as described herein, would otherwise be subject to colorable claims for recharacterization as equity, equitable subordination to other allowed claims, avoidance and/or disallowance.

III. THE DEBTORS' SALE PROCESS

A. The Global Bidding Procedures

51. On November 1, 2018, the Debtors filed the *Debtors' Motion for Approval of Global Bidding Procedures* [ECF No. 429] (the "Global Sale Motion"). By the Global Sale Motion, the Debtors sought approval of global bidding and sale procedures (the "Global Bidding Procedures") for the "efficient marketing, auction and sale of their assets . . . in an orderly and value maximizing manner . . . in order to consummate transactions for the highest and best value, all while protecting the due process rights of all interested parties." Global Sale Motion ¶ 2-3.

52. The Creditors' Committee opposed the Global Sale Motion and the proposed Global Bidding Procedures. On November 9, 2018 and November 14, 2018, respectively, the Creditors' Committee filed its *Preliminary Objection of the Official Committee of Unsecured Creditors of Sears Holdings Corporation,* et al. *to Debtors' Motion for Approval of Global Bidding Procedures* [ECF No. 640] (the "Preliminary Global Bid Procedures Objection") and the *Supplemental Objection of the Official Committee of Unsecured Creditors of Sears Holdings Corporation,* et al. *to Debtors' Motion for Approval of Global Bidding Procedures* [ECF No. 729] (the "Supplemental Global Bid Procedures Objection" and, together with the Preliminary Global Bid Procedures Objection, the "Global Bid Procedures Objections"), which was accompanied by a declaration by Steven Simms of FTI Consulting, Inc. (the "Simms Declaration").

53. By the Global Bid Procedures Objections, the Creditors' Committee expressed significant reservations with respect to the Debtors' pursuit of a going concern sale, for which, by all likelihood, ESL would be the only bidder.[24] Specifically, the Creditors' Committee argued that pursuing a going concern sale may not be a value maximizing strategy and, indeed, may lead to administrative insolvency, *see* Preliminary Global Bid Procedures Objection ¶ 6, leaving unsecured creditors to bear the substantial risks associated with pursuing a going concern sale. *See* Simms Decl. ¶ 24. As such, the Creditors' Committee urged the Debtors to pivot to a GOB sale process, or at least be prepared to pivot immediately to such a process if and when it became clear that no viable going concern bid exists. *See* Supplemental Global Bid Procedures Objection ¶ 8. The Debtors, in their reply, disputed the views of the Creditors' Committee and characterized the Global Bid Procedures Objections as premature and uninformed. *See Debtors' Omnibus Reply in Support of Motion for Approval of Global Bidding Procedures* [ECF No. 683] ¶¶ 9, 12-14.

54. On November 15, 2018, the Court held a hearing to consider the Debtors' Global Sale Motion (the "<u>November 15 Hearing</u>"). At the November 15 Hearing, this Court recognized the concerns raised by the Creditors' Committee in the Global Bid Procedures Objections, as well as the uncertain and imprecise process by which the Debtors would entertain bids other than a going concern proposal, such as GOB bids. *See, e.g.*, Nov. 15 Hr'g. Tr. 42:16-19 ("I'm clearly guided by case law that says the whole point of a sale process is to maximize value, and ***I'm***

[24] The Debtors always acknowledged, "ESL may be the only bidder for the Debtors' assets on a going-concern basis." *Reply in Support of Debtors' Application for an Order Authorizing the Retention and Employment of Evercore Group L.L.C. as Investment Banker for the Debtors Nunc Pro Tunc to the Petition Date*, dated Nov. 13, 2018 [ECF No. 671] (the "<u>Evercore Reply</u>") ¶ 4; *see also* First Day Decl. ¶ 15 ("The Debtors are in discussions with ESL regarding a stalking-horse bid for the purchase of the Company's viable store base.").

reluctant to cut out a potential source [i.e., GOB proposals] of the highest and best value.") (emphasis added).

55. As such, this Court instructed the Debtors to modify the Global Bidding Procedures to provide that the Debtors would consider all reasonable alternatives in parallel, and that the Debtors would provide regular updates to the Creditors' Committee on its wind-down preparations in the event a going concern sale did not materialize. *Id.* at 54:10-16 (noting that "the Debtors will prepare a Debtor-run going concern – an analysis for a Debtor-run GOB sale, and will frequently and periodically update the committee on that process.").

56. After the entry of the order approving the Global Sale Motion [ECF No. 816] (the "Global Bidding Procedures Order"), the Debtors embarked on a process of soliciting bids for their assets, purportedly both on going concern and liquidation bases. *Notice of Filing of Global Bidding Procedures Process Letter*, dated November 21, 2018 [ECF No. 862], Ex. 1 (the "Global Bidding Procedures Process Letter"), at 4. Further, with respect to liquidator bids, the Debtors solicited cash and non-cash considerations bids (*e.g.*, equity, hybrid, fee, debt or designation rights). *Id.*

57. Distinct from the sale process for the operating businesses or liquidation sales, the Debtors also began to market their real estate portfolio on a separate, compressed timeline. To facilitate the sale of real estate, the Debtors engaged Jones Lang LaSalle Americas, Inc. [ECF No. 1081] ("JLL"). At the outset, the Debtors' intent was to market a small number of "non-core" properties for sale, none of which would include the 425 properties constituting the "go forward stores." Subsequently, however, the Debtors expanded their process to include marketing for the entirety of their real estate portfolio. Specifically, the Debtors sought bids for [redacted] total real estate assets, including [redacted] unencumbered assets owned and leased by Debtors,

[redacted] encumbered assets owned and leased by Debtors, and [redacted] encumbered assets owned and leased by non-Debtor affiliates.

58. While the Global Bidding Procedures contemplated definitive bids from interested parties for the Debtors' assets on a going-concern basis by December 28, 2018, the Debtors' real estate process only sought *non*-binding indicative bids by the same date. *See* Letter from Jones Lang LaSalle Americas, Inc., at 1 (Nov. 30, 2018). The solicitation process for the Debtors' real estate did not commence until December 2, 2018, when JLL began its outreach through an "email blast," alerting potential buyers to submit bids for the Debtors' real estate assets. On December 21, 2018—a week before indicative bids were due—JLL launched official marketing websites and data rooms for the full set of Debtors' real estate assets. Upon information and belief, however, the Debtors contacted only parties who had previously bid on assets and, in the case of leased assets, certain landlords.

59. In response to the Debtors' marketing efforts, certain parties other than ESL conducted diligence on the assets, and several parties submitted bids for various parts of the Debtors' businesses or assets. Specifically, the Debtors received:

- [redacted] liquidation bids, including both equity and fee proposals, the economic terms of which increased materially from the indications of interest to the definitive bids;
- [redacted] bids for the Visa/MasterCard antitrust litigation claims;
- indications of interest for a total of [redacted] of the Company's [redacted] real estate properties, with several assets receiving multiple bids and approximately [redacted] bids of $0 or $1 (*i.e.*, placeholder bids generally meant to show interest or begin negotiations);
- [redacted] bids for franchise operations;

- [redacted] for certain parts of the Sears Home Services business and [redacted] bids for the PartsDirect business (other parties expressed interest in completing more due diligence before submitting a formal bid);[25]
- [redacted] for Sears Auto Centers;
- [redacted] for Monark;[26] and
- [redacted] for Innovel.[27]

60. As expected, ESL was the only party to submit a bid for substantially all of the Debtors' assets on a go forward basis. And, as described in the declaration of Saul Burian, of Houlihan Lokey, Inc. ("Houlihan Lokey"), the Creditors' Committee's investment banker, numerous parties expressed objection to the Debtors' sale process outside of the "going concern" sale process, including with respect to the Debtors' efforts, or lack thereof, to market their real estate portfolio and meaningfully engage and follow up with prospective bidders. *See generally* Declaration of Saul Burian, attached hereto as **Exhibit A** (the "Burian Declaration").

B. ESL's Initial Bids and the Auction

61. On December 5, 2018, ESL submitted an indicative bid (the "ESL Indicative Bid") pursuant to the Global Bidding Procedures.[28] The Debtors acknowledged to the Creditors' Committee that this bid was non-actionable, both legally and financially, and expressed in correspondence to ESL its view of the shortcomings in the ESL Indicative Bid, including that it failed to cash collateralize or otherwise backstop the credit bid and acquired assets owned by non-Debtors that the Debtors had no authority to assume. The Creditors' Committee, in turn,

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[25] Sears Home Services has various sub-business lines, including, among others, appliance and product repair services, sale of repair parts through its PartsDirect segment and origination of protection agreements and home warranties. *See* Sears Holdings Corp., 2017 Annual Report (Form 10-K) (March 23, 2018).

[26] Monark Premium Appliance Company ("Monark") is a nationwide distributor of home appliances that serves architects, builders, designers, developers and homeowners. *Id.*

[27] Innovel Solutions ("Innovel") provides delivery services for third-party customers. *Id.*

[28] *See* Sears Holdings Corp., General Statement of Acquisition of Beneficial Ownership (Form SC 13D/A) Ex. 99.81 (Dec. 6, 2018).

expressed its view to the Debtors that the ESL Indicative Bid: (i) failed to provide any cognizable value for unsecured creditors; (ii) purported to assign value to the assumption of claims against non-Debtors; (iii) contemplated the purchase of "substantially all" of the assets of the Debtors and certain non-Debtor affiliates which the Debtors have no ability to sell, but failed to allocate value to the individual assets as required by the Debtors' Global Bidding Procedures Process Letter;[29] (iv) failed to offer sufficient consideration for the assets contemplated to be purchased, including assets held by non-Debtors and valuable tax attributes that ESL would acquire as part of its bid, or to pay down the DIP ABL Facility[30] in full as required to credit bid; and (v) failed to provide a viable business plan for a profitable go-forward Sears in light of the staggering SG&A expense associated with continued operations.

62. On December 28, 2018, ESL submitted its definitive bid in accordance with the Global Bidding Procedures to acquire substantially all of the Debtors' go-forward retail footprint and other assets and component businesses of Sears.[31] Following submission of ESL's December 28 bid, the Debtors' advisors engaged with ESL and its advisors to discuss the infirmities of the bid. On December 30, 2018, counsel to the Debtors informed counsel to the Creditors' Committee that it expected ESL's bid would not be a "Qualified Bid" under the Global Bidding Procedures and, accordingly, the Debtors expected to pivot to a wind-down.

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[29] *See* Global Bidding Procedures Process Letter ("Bid must include an allocation of value to various assets included in the Transaction. For example, in an Indicative Bid for Sears NewCo, please include the allocation of value to Retail NewCo and SHS."); *see also* Global Bidding Procedures § VI(D)(3)(b).

[30] "DIP ABL Facility" has the meaning ascribed to such term in the *Final Order (I) Authorizing the Debtors to (A) Obtain Post-Petition Financing, (B) Grant Senior Secured Priming Liens and Superpriority Administrative Expense Claims, and (C) Utilize Cash Collateral; (II) Granting Adequate Protection to the Prepetition Secured Parties; (III) Modifying the Automatic Stay; and (IV) Granting Related Relief* [ECF No. 955] (the "Final DIP Order").

[31] *See* Sears Holdings Corp., General Statement of Acquisition of Beneficial Ownership (Form SC 13D/A, Ex. 99.81) (Jan. 2, 2019).

63. On January 4, 2019, the date the Debtors were required to notify bidders as to whether they were "Qualified Bidders" under the Global Bidding Procedures, the Debtors advised the Creditors' Committee and others that the Debtors would begin pivoting to a liquidation process as soon as the following week. The Debtors explained that this decision came as a result of ESL's failure to satisfy certain threshold conditions the Debtors had identified for the ESL's December 28 bid to be considered a "Qualified Bid." ESL's counsel acknowledged that the Debtors were clear as to the necessary conditions for its bid to be considered qualified and that ESL had not satisfied such conditions.

64. On January 8, 2019, this Court held a status conference (the "January 8 Status Conference") at which the Debtors announced ESL had agreed to fund the costs of the estates through the auction to be held on January 14, 2019 (the "Auction") as ESL worked to improve its bid. *See* Jan. 8, 2019 Status Conf. Tr. 9:17-25 ("After you know, several days of virtually around the clock negotiations and you know, some conversations with the court and our consultation parties[,] the debtors have determined that they will not be adjourning the auction on January 14, and that subject to ESL putting in a revised form of bid letter, APA as well as a deposit for 120 million dollars by 4:00PM tomorrow, that the debtors will be reviewing that bid and comparing it against the company's other alternatives at an auction on January 14."). In addition, in light of the significant cash burn associated with delaying a pivot to a liquidation to hold the Auction, the parties agreed that $17.9 million of the $120 million deposit—representing the cash burn of delaying GOB sales—would be non-refundable and paid to the estate if ESL were to lose the Auction. *Id.* at 10:8-18.

65. This Court summarized the difficult position in which the Debtors found themselves. First, the Court noted that at the Auction, the Debtors should be evaluating "all their

alternatives . . . including the potential liquidation under the auspices of one or other group of liquidators and the realization by the debtors on their assets that wouldn't be involved in a liquidation. *Id*. at 10:8-18. Second, this Court recognized that, while it appeared to be a "good development" that there was a potential going-concern bid, "the debtors have an obligation to review all of their alternatives and will do so at the auction." *Id*. at 14:1-9. The Court continued, explaining its expectation of the Auction as such that "the debtors will be evaluating the ESL proposal as against their alternatives. Those alternatives are somewhat open ended. They include not only bids that have been made so far . . . by sort of the larger liquidation firms, but also their assessment of the value of assets that are not included in those bids, and that includes potential litigation claims." *Id*. at 16:12-19.

66. In accordance with the Court's instructions, on January 9, 2019, ESL submitted a revised bid in an attempt to remedy the identified defects (such bid, including as modified thereafter and during the Auction, the "ESL Bid"). The Debtors again determined that ESL's January 9 revisions failed to solve for administrative solvency and continued to contain the infirmities identified in the prior rejected bids. Moreover, on January 11, 2019, the Creditors' Committee communicated to the Debtors its concerns with the ESL Bid, including, among other things, that the ESL Bid: (i) assumed various administrative liabilities, yet under the terms of APA, such payments were wholly illusory; (ii) contained numerous closing conditions that rendered the agreement a one-way option; and (iii) required the payment of a $30 million expense reimbursement, contrary to the Global Bidding Procedures Order prohibiting such provisions absent further order of the Court. Global Bidding Procedures Order ¶ 10. The Creditors' Committee also expressed its serious concerns that the Debtors might pursue the ESL Bid at tremendous cost and risk to the estates, and insisted that the Debtors instead pivot to the

responsible, value-maximizing course of proceeding with GOB sales, while preserving or prosecuting all of the estates' valuable causes of action against Lampert, ESL and related parties. The January 11 letter also identified numerous issues with the APA.

67. On information and belief, on January 12, 2019, Debtors' counsel provided ESL with a proposed mark-up of the APA. The Debtors' proposed revisions of the APA, however, did not resolve many of the most significant issues with the ESL Bid identified by the Creditors' Committee. The Creditors' Committee's position, which its counsel communicated to the Board by subsequent letter on January 13, 2019—the eve of the Auction—was that even if ESL capitulated on ***every single "ask"*** by the Debtors in their mark-up, the ESL Bid remained entirely non-actionable as, among other things, it did not resolve many of the material issues, including rendering the Debtors' estates administratively insolvent and failing to resolve substantial uncertainty as to whether a sale could close on the timeline and under the conditions required by ESL and whether Sears NewCo could survive as a viable enterprise.

68. At the Auction on January 14, however, ESL held firm on the terms of its bid. After waiting until the day of the Auction to respond to the Debtors' revisions, ESL rejected many of the Debtors' demands. Despite the reality that—as the Debtors also have acknowledged to this Court—continued delay of a GOB process in pursuit of the ESL Bid costs the estates in excess of $6 million per day, the Debtors once again relented to ESL and continued the Auction to January 15, 2019 without requiring ESL to fund the additional $6 million per day burn. On January 15, 2019, the Debtors continued to reject the ESL Bid. The Debtors stated on the record that the ESL Bid was "not otherwise higher or better when compared to the company's alternatives," based on, among other things, administrative insolvency concerns. *See* Transcript of January 15 Auction (the "January 15 Auction Transcript") at 50:23-51:10, 52:2-10.

Moreover, as ESL sought to improve its bid, the Debtors continued to view these changes as immaterial or otherwise required by law or order of the Court—as, for example, ESL's "agreement" to remove its requested $30 million expense reimbursement when such reimbursement contravened the Global Bidding Procedures Order. *See id.* at 58:17-21. Specifically, the Debtors identified a number of infirmities with the ESL Bid, such as: (i) transfer taxes reducing the purchase price; (ii) "unresolved" issues with respect to the credit bid; (iii) "significant" closing risk attendant to the transaction, which "risk was primarily being borne by the estate for getting to the closing and without recourse to the remainder of the deposit"; and (iv) issues surrounding the KCD IP, LLC license agreements and the resulting $100 million administrative claim. *See id.* at 59:16-60:4, 60:18-61:4.

69. Moreover, the Special Committee of the Restructuring Committee of the Board (the "Restructuring Subcommittee")—tasked with evaluating the potential claims against ESL—stated on the record its misgivings with respect to the ESL Sale:

> The subcommittee has reached the conclusion that substantial claims exist against ESL and its affiliates, as well as other defendants relating to ESL's ***abuse of its control*** of the debtors and the transfer of hundreds of millions of dollars of assets to ESL and its affiliates for inadequate consideration. Those transfers hurt Sears and its employees.

Id. at 63:12-21 (emphasis added). Counsel to the Restructuring Subcommittee also explained as follows:

> ***[A]ny benefits of the ESL transaction are ephemeral*** . . . for the reason that the company does not have sufficient cash to close the transaction. Administrative solvency is a commitment by the company to pay back those parties that provide goods and services to the estate post-petition, so it can conduct a reorganization and get to the other side. ESL's bid leaves the company admittedly administratively insolvent.

Id. at 66:3-15 (emphasis added).

70. After ESL's counsel touted a number of so-called concessions to the latest draft APA, Debtors' counsel made clear that a majority of such changes were required by applicable law or orders of this Court or otherwise were far less favorable than ESL had asserted. Specifically, with respect to the assumption of claims pursuant to Bankruptcy Code section 503(b)(9) (the "503(b)(9) Claims"), Debtors' counsel explained that while the Debtors appreciated the modification, such change was required as "that's just the law" and further explained that "while I appreciate the [*sic*] ESL made those changes, I don't think the court really had the ability to modify those terms otherwise." *Id.* at 58:7, 10-14. With respect to elimination of ESL's requested $30 million expense reimbursement, Debtors' counsel explained that such expense reimbursement "was being requested in contravention of the global asset bidding procedures order," and as such, had to be removed. *Id*. at 58:17-21. Finally, with respect to the proposed assumption of additional severance obligations, Debtors' counsel noted that the extension of severance payments through fiscal year 2020, in effect, only added an additional month of severance payments from prior offers. *Id*. at 59:12-15. Debtors' counsel then concluded by stating: "I can speak personally that we have done everything we can to try and make this work." *Id*. at 62:7-9.

71. On January 16, 2019, despite the myriad ongoing deficiencies inherent in the ESL Bid, as identified by the Debtors' advisors themselves less than 12 hours prior to the announcement, and after refusing to consult with the Creditors' Committee regarding the purported modifications to the ESL Bid as required by the Global Bidding Procedures Order despite confirming its obligation to do so,[32] the Debtors designated ESL as the Successful Bidder

[32] *See* Jan. 15 Auction Tr. 40:11-19 ("[W]e decided late last night to allow ESL overnight to put together a response to the proposal from the debtors, and at this time, we will have them put that proposal on the record, ***after which time we are going to take a break, go discuss it with the restructuring committee and the consultation parties***.")

(as defined in the Global Bidding Procedures Order).[33] Despite the Court's clear instructions at the January 8 status conference, the Debtors made no serious effort to facilitate a competitive process that could have led to value-maximizing proposals.

C. The ESL Bid

72. The material terms of the ESL Bid, as accepted by the Debtors on January 16, and pursuant to the terms of documentation finalized on January 17, are set forth below. The specific terms of the APA, including myriad closing conditions, termination events and other obligations of the parties are discussed later herein. *See infra* Objection, Part II.B.2-3.

73. **Acquired Assets.** The ESL Bid contemplates Buyer's acquisition of substantially all of the Company's assets, including, but not limited to:

- a go-forward retail footprint of approximately 425 retail stores under the "Sears" and "Kmart" brands and certain other owned and leased real estate interests;
- the Kenmore business, the DieHard business, various websites and the Shop Your Way loyalty program;
- certain contracts and agreements, including rights to have the Sellers assume and assign to Buyer certain leases after the closing occurs under the APA (including certain manufacturer's warranties and repaid services contracts);
- all Acquired Inventory, all Acquired Receivables, all Acquired Equipment and all Acquired Improvements and the right to receive certain Pending Inventory;
- certain intellectual property owned by the Sellers;
- certain prepaid taxes and certain rights to any refund, rebate or credit of taxes;

(emphasis added); *id*. at 75:6-17 ("[W]e will have a brief adjournment just for the restructuring committee to consider the proposal that has been made on the record and we will come back on with the restructuring committee's decision. . . . ***I should have added and will consult with the consultation parties before coming back on record***.") (emphasis added) (internal quotations omitted).

[33] *See* Transcript of January 16 Auction 76:20-77:5 ("So on behalf of the debtors and particularly the restructuring committee, having considered ESL's revised proposal and the material increase and consideration that has been put on the table, after deliberation, the restructuring committee has decided to accept the ESL offer as a higher or better offer, subject to, importantly, documentation.").

- subject to compliance with the APA including obtaining the required Bermuda Monetary Authority approval, the KCD Notes;

- certain Credit Card Claims, representing estimates potential damages of $400 million, arising from Seller's involvement as a class plaintiff in the class actions consolidated in the multi-district litigation *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, No. 1:05-MD-01720 (E.D.N.Y.) against Visa Inc., Mastercard Inc., JPMorgan Chase & Co, Citigroup N.A., Bank of America N.A. and other defendants, and any proceeds or settlement proceeds thereof; and

- the proceeds from the closing of the sale under the Asset SHIP Purchase Agreement as defined in the *Order (I) Approving the Sale of the Sears Home Improvement Business and (II) Granting Related Relief* [ECF No. 1417] (the "SHIP Purchase Agreement") in the amount of approximately $45,000,000, or, if the transactions under the SHIP Purchase Agreement are not consummated, certain assets as described in the SHIP Purchase Agreement.

See Sale Notice, Ex. A (Material Terms of the Successful Bid) (the "ESL Bid Term Sheet"), at 1-3; APA § 2.1.

74. **Release.** In addition, the ESL Bid contemplates a release (the "Release") in exchange for $35 million (the "Release Consideration") and "other good and valuable consideration provided to the Debtors and their estates by ESL in connection with the Transactions." APA § 9.13(a); *see also* Proposed Sale Order ¶ 7(a)-(d). The "other good and valuable consideration" is unidentified. By the Release, the Debtors propose to release ESL (including Lampert and any of ESL's respective directors, officers or employees, in such capacities and their individual capacities) from Released Estate Claims.[34] These Released

[34] The APA defines "Released Estate Claims" to include "any and all Claims and causes of action of the Debtors and their estates against ESL arising under (i) sections 363(k), 502(a) or 510(c) of the Bankruptcy Code, (ii) equitable principles of subordination or recharacterization, or (iii) any other applicable Law that could be asserted to challenge the allowance of the ESL Claims pursuant to section 9.13(c). For the avoidance of doubt the Released Estate Claims do not include any other Claims or causes of action of the Debtors or their estates against ESL or any other Person, including but not limited to any Claims or causes of action (i) for constructive or actual fraudulent transfer under 11 U.S.C. 544(b) or 550(a) or any applicable state or federal law, for breach of fiduciary duty (including any Claims for breach of fiduciary duty in connection with the incurrence of any debt described on Exhibit G), or for illegal dividend under 8 Del. C. 170-174 or any other state law; (ii) that are related to Lands' End, Inc., the "spin-off" (as such term is defined in the Information Statement of Lands' End, Inc. dated March 18, 2014), Seritage Growth

Estates Claims include, among other things: claims arising under (i) Bankruptcy Code sections 363(k), 502(a) or 510(c), (ii) equitable principles of subordination or recharacterization or (iii) any other applicable law that could be asserted to challenge the allowance of (a) the IP/Ground Lease Term Loan Facility, (b) the FILO Facility, (c) the Real Estate Loan 2020, (d) the Second Lien Term Loan, (e) the Second Lien Line of Credit Facility, (f) the Second Lien PIK Notes and (g) the Citi L/C Facility. *See* ESL Bid Term Sheet, at 7-8; APA § 9.13; Proposed Sale Order ¶ 7(a)-(d). By its terms, the Release releases any estate causes of action against ESL that would limit ESL's right to credit bid or challenge or collaterally attack the allowance of the ESL Claims on any basis.

75. **Purchase Price.** In exchange for substantially all of the Debtors' assets, along with the releases set forth herein, ESL purports to offer the following consideration for a headline price of $5.2 billion. *See* ESL Bid Term Sheet, at 3-4; APA § 3.1.

- $850 million in cash from a new ABL facility;
- $1,334 million in credit bids, comprising: (i) $544 million credit bid of the Consolidated Secured Loan Facility; (ii) $231 million credit bid of the IP/Ground Lease Term Loan; (iii) $125 million credit bid of FILO Term Loan; and (iv) $434 million in Second Lien Debt;
- $621 million in roll-over obligations, comprising: (i) $271 million in Stand-Alone L/C Facility; and (ii) $350 million in Junior DIP Facility;[35]

Properties, Inc., Seritage Growth Properties, L.P., or the "Transaction" (as that term is defined in the registration statement on Form S-11 filed by Seritage Growth Properties, which registration statement became effective on June 9, 2015), or (iii) that have been asserted by or on behalf of any party in interest in the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 cases captioned In the Matter of a Plan of Compromise or Arrangement of Sears Canada Inc., 9370-2751 Quebec Inc., 191020 Canada Inc., The Cut Inc., Sears Contact Services Inc., Initium Logistics Services Inc., Initium Commerce Labs Inc., Initium Trading and Sourcing Corp., Sears Floor Covering Centers Inc., 173470 Canada Inc., 2497089 Ontario Inc., 6988741 Canada Inc., 10011711 Canada Inc., 1592580 Ontario Limited, 955041 Alberta Ltd., 4201531 Canada Inc., 168886 Canada Inc., and 3339611 Canada Inc., Ontario Superior Court of Justice Court File No.:. CV-17-11846-00CL."

[35] "Junior DIP Facility" has the meaning ascribed to such term in the *Final Junior DIP Order (I) Authorizing the Debtors to (A) Obtain Post-Petition Financing and (B) Grant Secured Priming Liens and Superpriority Administrative Expense Claims; (II) Modifying the Automatic Stay; and (III) Granting Related Relief* [ECF No. 1436].

- $1,682 million in total assumption of non-administrative liabilities, comprising: (i) assumption of Sparrow liability; (ii) assumption of protection agreement liabilities; and (iii) assumption of Shop Your Way and gift card liabilities;
- $667 million in total assumption of administrative claims, comprising: (i) $139 million in assumed 503(b)(9) claims; (ii) $166 million in postpetition accounts payable (merchandise and non-merchandise); (iii) $20 million in severance and WARN obligations; (iv) $8 million in employee claims; (v) $134 million in property taxes; and (vi) $200 million in cure costs;
- $35 million in cash for the Release; and
- $17 million in cash for store register cash.

76. The Global Bidding Procedures required any bidder to allocate its purchase price in accordance with the value the bidder associates with each asset or group of assets. *See* Global Bidding Procedures § VI(D)(3)(b). Yet, the ESL Bid did not allocate the purchase price amongst the various assets being acquired.

77. **Business Plan**. In support of the ESL Bid, adequate assurance of future performance under assumed contracts and leases and the future envisioned for Sears NewCo, ESL has submitted the ESL Business Plan. The ESL Business Plan [redacted] Remarkably, however, ESL's initiatives for Sears NewCo [redacted].

78. Specifically, the ESL Business Plan bases the future success of Sears NewCo on certain key attributes: [redacted]

[redacted]. *See* ESL Business Plan, at 6. From these attributes, the ESL Business Plan builds out [redacted]

79. For Sears NewCo as a whole, the ESL Business Plan contemplates [redacted]

80. Notwithstanding its near decade-long decline, under the ESL Business Plan, Sears NewCo will [redacted]

[redacted] While Sears has not generated positive EBITDAP since 2012, the ESL Business Plan assumes that Sears NewCo [redacted]

OBJECTION

I. APPLICABLE LEGAL STANDARD

A. The ESL Sale Is Subject to Heightened Scrutiny that It Cannot Satisfy

81. This Court must apply heightened scrutiny to the ESL Sale due to ESL's status as an insider of the Debtors. Bankruptcy Code section 101(31) defines an insider of a corporate debtor to include, *inter alia*, a "(i) director of the debtor; (ii) officer of the debtor; (iii) person in control of the debtor; . . . or . . . affiliate [of the debtor], or insider of an affiliate as if such affiliate were the debtor . . . ." Affiliate, in turn, is defined as an "entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor . . ." 11 U.S.C. § 101(2). ESL qualifies as an insider because of its control over and sufficiently close relationship to the Debtors, including on account of its role as controlling shareholder (with Lampert), Chairman of the Board (through Lampert) and the beneficial holder of over 20 percent of the voting securities of the Debtors. *See Official Comm. of Unsecured Creditors of the Debtors v. Austin Fin. Serv., Inc. (In re KDI Holdings, Inc.)*, 277 B.R. 493, 511 (Bankr. S.D.N.Y. 1999) ("The legislative history of [Bankruptcy Code section] 101(31) indicates that the term applies to one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with

the debtor.") (internal citations and quotations omitted). Accordingly, the ESL Sale must be examined through a critical lens and subjected to heightened scrutiny.

82. The law is well-settled that an insider transaction, including a sale pursuant to Bankruptcy Code section 363, cannot be approved unless it is the product of an "arm's length bargain" with "inherent fairness from the viewpoint of" interested parties. *Pepper v. Litton*, 308 U.S. 295, 306-07 (1939); *see also Brewer v. Erwin & Erwin, P.C. (In re Marquam Inv. Corp.)*, 942 F.2d 1462, 1466 (9th Cir. 1991) (applying "rigorous scrutiny" to an insider's transactions with a bankrupt corporation); *In re Bidermann Indus. U.S.A., Inc.*, 203 B.R. 547, 551 (Bankr. S.D.N.Y. 1997) (noting that sales to insiders in chapter 11 cases necessarily are subjected to heightened scrutiny because such transactions are rife with opportunities for abuse); *C&J Clark Am., Inc. v. Carol Ruth, Inc. (In re Wingspread Corp.)*, 92 B.R. 87, 93 (Bankr. S.D.N.Y. 1988) (same). "'In applying heightened scrutiny, courts are concerned with the integrity and entire fairness of the transaction at issue, typically examining whether the process and price of a proposed transaction ***not only appear fair but are fair*** and ***whether fiduciary duties were properly taken into consideration***.'" *In re Residential Capital, LLC*, No. 12-12020, 2013 WL 3286198, at *19 (Bankr. S.D.N.Y. June 27, 2013) (emphasis added) (quoting *In re Innkeepers USA Trust*, 442 B.R. 227, 231 (Bankr. S.D.N.Y. 2010)).

83. Therefore, in determining whether to approve the ESL Sale, this Court must not only scrutinize the Debtors' business decision to pursue the ESL Sale, but also conclude that such decision was made in good faith and with due care, was not an abuse of discretion or a waste of corporate assets and was not driven by other factors. *Id.*; *see also In re Tidal Const. Co.*, 446 B.R. 620, 624 (Bankr. S.D. Ga. 2009) (stating that, in a sale context, heightened scrutiny requires a debtor to demonstrate "that the assets are being sold for the highest price

attainable" and "that [the] insider transaction is the result of bona fide arm's length transaction[ ] and not driven by other factors.").

84. Further to the fairness and good faith considerations attendant to ESL's insider status, the contemplated sale of substantially all of the Debtors' assets without the protections afforded to creditors by the plan confirmation process serves as independent and sufficient grounds for applying heightened scrutiny. *Mission Iowa Wind Co. v. Enron Corp.*, 291 B.R. 39, 43 (S.D.N.Y. 2003) (vacating bankruptcy court's order approving sale under Bankruptcy Code section 363(b) and stating that "[w]here a debtor attempts to sell substantially all of its assets pursuant to [Bankruptcy Code section] 363(b), instead of waiting for confirmation of a reorganization plan and the safeguards that that process provides, ***more than cursory scrutiny is required by the Bankruptcy Court***") (emphasis added); *In re President Casinos, Inc.*, 314 B.R. 784, 785 (Bankr. E.D. Mo. 2004) (stating that a sale of all, or substantially all, of the assets of a chapter 11 estate "in the absence of a confirmed plan," while not forbidden, "is subject to close scrutiny by creditors and the court"); *see also In re Gulph Woods Corp.*, No. 87-03093S, 1988 WL 134688, at *4 (Bankr. E.D. Pa. Dec. 13, 1988) (noting that "there must be a strong showing of adequate notice and good faith, as well as ***feasibility***, of the transaction, to prompt us to approve a pre-confirmation [Bankruptcy Code section] 363(b)(2) sale") (emphasis added) (internal citations and quotations omitted).

85. Against the backdrop of (i) the unsubstantiated and fanciful ESL Business Plan, (ii) the high likelihood of the Debtors' administrative insolvency following consummation of the ESL Sale as compared to the greater likelihood of administrative solvency in connection with an asset-by-asset monetization, (iii) the inappropriate credit bid of the disputed Credit Bid Claims; (iv) the viable and valuable causes of action underlying the Standing Motion and Proposed

Complaint (certain of which are to be released for *de minimis* consideration in connection with the ESL Sale) and (v) the flaws in the Debtors' sale process and wind-down analysis, as well as the myriad deficiencies in the APA, the ESL Sale does not—and cannot—withstand heightened scrutiny.

B. The ESL Sale Would Not Even Satisfy the Lesser Business Judgment Test

86. The evidence makes clear that pursuit of the ESL Sale is not a sound exercise of business judgment. *See Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.)*, 4 F.3d 1095, 1099 (2d Cir. 1993); *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1071 (2d Cir. 1983) ("The rule we adopt requires that a judge determining a [Bankruptcy Code section] 363(b) application ***expressly find from the evidence presented before him at the hearing a good business reason*** to grant such an application.") (emphasis added).

87. In *Lionel*, the Second Circuit promulgated a non-exhaustive list of factors to guide courts in determining whether a good business reason exists for a proposed section 363 transaction, including: (i) proportionate value of the asset to the estate as a whole; (ii) the amount of time that has elapsed time since the filing; (iii) the likelihood that a plan of reorganization will be proposed and confirmed in the near future; (iv) the effect of the proposed disposition on future plans of reorganization; (v) the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property; (vi) which of the alternatives of use, sale or lease the proposal envisions; and (vii) whether the asset is increasing or decreasing in value. 722 F.2d at 1071.

88. This Court has cited the standard set forth in *Orion* numerous times during the pendency of these Chapter 11 Cases and has articulated its clear application to approval of a sale pursuant to Bankruptcy Code section 363. For example, during the hearing held on December 14, 2018 regarding the Debtors' key employee retention plan, this Court explained that

"[u]ltimately, the bankruptcy judge has to apply his or her own sense of whether the decision is in good exercise of business judgment, informed by all the facts and circumstances as laid out on the record."). Dec. 14 Hr'g Tr. 39:20-40:18.

89. The *Orion* business judgment standard militates against approval of the ESL Sale for the reasons discussed herein. Unlike with respect to the Debtors' earlier motions, however, this Court cannot take "comfort" in sophisticated financial stakeholders' "lack of objection or . . . support of the [ESL Sale]." Dec. 14 Hr'g. Tr. 40:14-16. Indeed, the Creditors' Committee has questioned the propriety of any ESL-sponsored transaction since the Debtors first sought approval of their sale processes[36] and has continued to voice its concerns to the Court, the Debtors, the Board, the Restructuring Subcommittee and their respective advisors throughout the pendency of these cases.

90. Moreover, this Court cannot defer to the independence of the parties involved. As set forth in the Standing Motion and Proposed Complaint, the trajectory of these Chapter 11 Cases has been primarily for the benefit of ESL, a hopelessly conflicted insider of the Debtors, that, at Lampert's direction, (i) manipulated the Debtors' projections for ESL's benefit, (ii) engaged in nearly a decade of serial asset stripping, (iii) cost over 250,000 employees their jobs and (iv) syphoned Sears's best assets out of the enterprise to shield them from the claims of other creditors and maximize ESL's own investments in anticipation of these inevitable bankruptcy cases. The Debtors' dependence on ESL's directives was further evidenced during the Auction,

[36] *See* Preliminary Global Bid Procedures Objection ¶ 12 (explaining that the Debtors made clear on the first day of the Chapter 11 Cases that causes of action arising from affiliate transactions involving ESL prior to the Petition Date may exist and requesting that the Global Bidding Procedures expressly provide that "ESL cannot credit bid on any assets that the Debtors propose to sell, whether for the Go Forward Stores or otherwise, until the Creditors Committee completes its investigation and determines whether to pursue claims and causes of action against ESL."); Supplemental Global Bid Procedures Objection ¶ 10 (expressing concerns with respect to any credit bid by ESL because ESL is "the target of significant investigations by the [Restructuring Subcommittee] and the Creditors' Committee, which investigations may result in claims . . . [against] ESL.")

when the Debtors failed to consult with the Creditors' Committee—despite their requirement to do so under the Global Bidding Procedures—in approving the ESL Sale, thus raising significant questions regarding the independence of the Debtors and the Restructuring Committee from ESL. For the reasons set forth herein and that will be demonstrated at trial, the ESL Sale, including the contemplated credit bid and Release (for which minimal value is to be provided), does not meet the applicable legal standards for approval and, as such, the ESL Sale must be rejected by this Court.

II. THE DEBTORS HAVE FAILED TO MEET THEIR BURDEN OF SHOWING THAT THE ESL SALE IS IN THE BEST INTERESTS OF THE DEBTORS' ESTATES

91. The Debtors have determined that the ESL Sale is the highest and best offer for their assets because it is a "going concern" transaction that "would preserve 45,000 jobs" in exchange for $5.2 billion in consideration.[37] The Debtors, however, never undertook any critical analysis of the business plan underpinning the "going concern" nature of the ESL Sale or the likelihood that the preservation of 45,000 jobs at this time is anything more than a short reprieve from the inevitable wind-down of Sears. Indeed, the Debtors' designation of the ESL Sale as the highest and best alternative for these estates as compared to the value that would be obtained and preserved in an orderly wind-down of the Debtors' businesses does not withstand scrutiny and does not comport with their fiduciary duty to maximize the value of their estates. *See Lawsky v. Condor Capital Corp.*, No. 14 CIV. 2863 (CM), 2015 U.S. Dist. LEXIS 96347, at *24 (S.D.N.Y. July 21, 2015).

92. The Debtors' fiduciary duty to maximize the value of their estates does not mandate that a debtor "mechanically accept" the bid with the highest dollar amount. *Id.* (citing

[37] *See* ESL Press Release; ESL Partners, L.P., Beneficial Ownership Report (Schedule 13-D) (Jan. 18, 2019), Item 4.

In re Family Christian LLC, 533 B.R. 600, 622 (Bankr. W.D. Mich. 2015)). Instead, a debtor must demonstrate that the contemplated purchase price is the highest and ***best*** offer, which includes considerations of good faith and feasibility. *Family Christian*, 533 B.R. at 626; *Gulph Woods Corp.*, 1988 WL 134688, at *4 (emphasis added) (noting that "there must be a strong showing of adequate notice and good faith, as well as ***feasibility***, of the transaction, to prompt us to approve a pre-confirmation" sale pursuant to Bankruptcy Code section 363) (emphasis added) (internal quotations omitted). Accordingly, a court should consider the future use of the assets contemplated to be sold in connection with determining whether to approve a sale under Bankruptcy Code section 363, as that future use will have a material impact on the treatment of the debtor's creditors.[38] While preserving a debtor as a going concern and saving jobs is a laudable goal of chapter 11, it must be balanced with—and cannot override—the equally fundamental tenet of maximizing value for a debtor's creditors. *See Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 453 (1999) (describing "the two

[38] As the Court likely is aware, debtors operating in the brick-and-mortar retail space often emerge from chapter 11 only to land in "chapter 22," as proposed go-forward business plans and forecasts prove overly optimistic—and ultimately unrealistic—in a period of intense competition and shifting market dynamics. *See, e.g.*, *In re Gymboree Grp., Inc.*, No. 19-30258 (KLP) (Bankr. E.D. Va.), *Decl. of Stephen Coulombre, Chief Restructuring Officer of Gymboree Group, Inc., in Support of Chapter 11 Petitions and First Day Motions* [ECF No. 11] ¶ 8 ("[T]he unanticipated degree of decline of the brick-and-mortar retail industry, among other factors, has made it increasingly difficult for the Debtors to support their cost and capital structure. The combination of declining profitability and general market uncertainty has hampered the Debtors' ability to sustain their funded debt burden and to commit the capital necessary for investing in their operations. Poorer-than-expected product sales led to deep in-store merchandise discounting, which in turn led to thinner profit margins."); *In re The Great Atl. & Pac. Tea Co.*, No. 15-23007 (RDD) (Bankr. S.D.N.Y.), *Decl. of Christopher W. McGarry Pursuant to Rule 1007-2 of the Local Bankruptcy Rules for the Southern District of New York* [ECF No. 4] ¶ 34 (stating that "[t]his is the Debtors' second bankruptcy in just five years. A&P previously filed the 2010 Cases seeking to achieve an operational and financial restructuring . . . . Unfortunately, despite best efforts and the infusion of more than $500 million in new capital in the 2010 Cases, A&P did not achieve nearly as much as was needed to turn around its business and sustain profitability."); *In re The Wet Seal, LLC*, No. 17-10229 (CSS) (Bankr. D. Del. 2017), *Decl. of Judd P. Tirnauer in Support of Chapter 11 Petitions and Requests for First Day Relief* [ECF No. 19] ¶ 11 (noting the financial challenges that have plagued the debtors in the wake of their prior chapter 11 cases and stating that "[t]hese collective challenges were amplified by unexpected operational hurdles that arose from relocation of the corporate headquarters and the transition to a third party distribution center . . ."). Commentary on retail "chapter 22s" points out that the common trait underlying such filings is a focus on de-leveraging while failing to fix the underlying company's operations—characteristics that are present in the ESL Sale and ESL Business Plan. *See, e.g.*, Petition, Interview with T. Gavin (Jan. 23, 2019), available at https://petition.substack.com/.

recognized policies underlying [c]hapter 11" as "preserving going concerns and maximizing property available to satisfy creditors") (citations omitted). Ultimately, the determination of what constitutes the "highest and best" offer in an auction conducted pursuant to Bankruptcy Code section 363 must be determined on the basis of value maximization, not job preservation. *See In re After Six, Inc.*, 154 B.R. 876, 883-84 (Bankr. E.D. Pa. 2010) (holding that, despite policy goal of chapter 11 to preserve jobs, potential purchaser's non-guaranteed offer to employ debtor's former employees could not outweigh greater purchase price of competing bid).

93. Here, while the Creditors' Committee certainly is cognizant of the public interest in preserving jobs, such interest alone cannot justify the Debtors' decision to choose a path that is not value maximizing. This particularly is true in these Chapter 11 Cases given that the ESL Sale likely will result in a financially unviable Sears NewCo (rendering any offer of continued employment entirely illusory).[39] By contrast, under any analysis, value would be maximized through an orderly asset monetization and GOB process. *See United States v. Deer Park, Inc. (In re Deer Park, Inc.)*, 136 B.R. 815, 818 (B.A.P. 9th Cir. 1992), *aff'd*, 10 F.3d 1478 (9th Cir. 1993) (upholding orderly liquidation as valid option in chapter 11 where "a debtor's continuing participation in a planned, orderly liquidation may in fact be necessary to bring about the maximum recovery for the creditors.").

94. As discussed herein, the unfortunate confluence of (i) the deeply flawed and unreasonably optimistic ESL Business Plan; (ii) the Debtors' virtually guaranteed administrative insolvency under the ESL Sale, (iii) the numerous flaws in the APA, (iv) the inappropriate credit bid of disputed claims; (v) the *de minimis* consideration to be provided by ESL for the release

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[39] Moreover, the APA does not require Buyer to continue employment (or refrain from terminating any employee) for any period of time, and Buyer's obligation to pay severance to terminated employees is capped. *See* APA § 9.7(a).

that will allow its credit bid and (vi) the superior recoveries that would be available to the Debtors' creditors through orderly asset monetization, compounded by the fatal defects in the Debtors' marketing and auction process, all militate in favor of the value-maximizing alternative of a GOB process. Accordingly, for the reasons set forth herein, the ESL Plan fails to represent the highest ***or*** the best alternative available to the Debtors and, as such, does not comport with a sound exercise of the Debtors' business judgment.

A. The ESL Sale Is Non-Actionable as Sears NewCo Is Not a Viable Go Forward Business

95. The ESL Business Plan is premised upon false and flawed assumptions and fails to offer a viable go-forward strategy. Indeed, even a cursory review of the ESL Business Plan shows it to be, at best, wishful thinking and, at worst, another layer of ESL's smokescreen to enable it to continue its own out-of-court liquidation of Sears for its own benefit and to the detriment of third-party creditors.

1. The ESL Business Plan Is Unrealistic and Unreasonable

96. The ESL Business Plan suggests that Sears NewCo will [redacted] Specifically, the ESL Business Plan contemplates [redacted]. At the same time, the ESL Business Plan claims [redacted] All this with no explanation for how it is to be accomplished.

97. In addition, the ESL Business Plan:

- raises serious doubts as to whether Sears NewCo can satisfy its obligations or become a truly viable business;

- [redacted] 40 [redacted]
- [redacted]
- [redacted]
- [redacted];
- [redacted]; and
- [redacted]

98. In short, the ESL Business Plan and its going-forward projections for Sears NewCo are fantasy. It continues the Sears tradition of unrealistic projections and depends on previously (and currently) unsuccessful business initiatives to achieve results. Significantly, the

[40] All proceeds are presumed to pay down the Junior DIP Facility and, with the full $350 million outstanding balance being assumed, it is likely that even more assets will need to be sold.

ESL Business Plan touts employment numbers that are not feasible and that will only become less realistic as the anticipated downturn of Sears NewCo takes effect.

99. The key to Sears NewCo's promised economic achievements under the ESL Business Plan is that Sears will undergo a miraculous transformation from a struggling retailer with declining sales year-over-year to a [redacted]. Jan Kniffen, the Creditors' Committee's expert concerning retail strategies and business planning with decades of experience as a senior executive in the retail industry, opines that like prior financial plans generated by Sears during the ESL period, actual financial results will be worse than those forecasted. A more likely outcome should Sears NewCo pursue the stated plan is that the company would continue its longstanding, downward trajectory of divesting assets, cutting jobs and losing money. *See generally* Kniffen Report.

100. Sears has been deteriorating for years, and the ESL Business Plan offers no new initiatives that would be sufficient to reverse the trend. The turnaround upon which the ESL Business Plan is premised is made all the more unlikely in a challenging retail environment in which Sears must compete with thriving big box chains like Walmart, Target, Home Depot, and Lowe's, in addition to the rapid expansion of online retailers like Amazon and the equally rapid decline of regional malls where Sears has made its home. *See id.* ¶¶ 30-40.

101. The ESL Business Plan ignores that Sears had been failing for nearly a decade before filing for bankruptcy protection in October 2018. Its topline revenue declined from over [redacted]. *Id.* ¶ 24 & Ex. 1. At the same time, the total number of Sears stores has declined almost 90 percent, from 4,038 in 2010, 505 in 2018 and 425 as of today. *Id.* ¶¶ 24, 26 & Ex. 1. Yet its radically smaller footprint has not translated to profitability—if anything, the

opposite is true. Sears has not generated positive EBITDAP since 2012 and has reported operating losses of over $500 million for each of the last four years. *Id.* ¶ 25 & Ex. 2. Sears's decline can be attributed, in part, to a challenging retail environment that has taken its toll on traditional brick and mortar stores. *See id.* ¶¶ 30-40. But Sears has underperformed even compared to its peers, losing same-store sales at a far greater rate than comparable companies like Macy's and Kohl's. *Id.* ¶ 29 & Ex. 4.

102. Not only did Sears underperform as compared to its peers, it also consistently failed to meet its own internal targets, year after year. Between 2010 and 2017, it missed its revenue, gross margin and EBITDAP targets ***every single year***. *Id.* ¶¶ 56-58 & Exs. 10-12. During this timeframe, it missed its revenue targets by an average of [redacted]; it missed its gross margin targets by an average of [redacted]; and it missed its EBITDAP targets by an astonishing yearly average of $1.4 billion, repeatedly predicting positive EBITDAP and then operating at massive losses. *Id.* Sears's pattern of repeated EBITDAP misses is set forth in detail below.

[redacted]

103. The ESL Business Plan, however, reads as though none of this history ever occurred. Notwithstanding its near decade-long decline, under the ESL Business Plan, Sears NewCo purportedly will now emerge from bankruptcy and [redacted] While Sears has not generated positive EBITDAP since 2012, the ESL Business Plan assumes that Sears NewCo [redacted] This kind of turnaround, set forth in the charts below, simply is unheard of and is not remotely achievable. *Id.* ¶ 67 [redacted] *see generally id.* ¶¶ 62-71. There is every reason to believe Sears NewCo will [redacted] just as it missed its targets every year since 2010.

**Comparison of Sears Prior EBITDAP to Forecasted EBITDAP in the 2019 ESL Business Plan
2015 - 2021**

[redacted]

**Sears Business Unit EBITDAP Margin before Deducting Corporate SG&A and Other Adjustments
2015 - 2021**

[redacted]

104. Over the years, Sears devised several initiatives to try to right the ship, including [redacted] And in every management plan

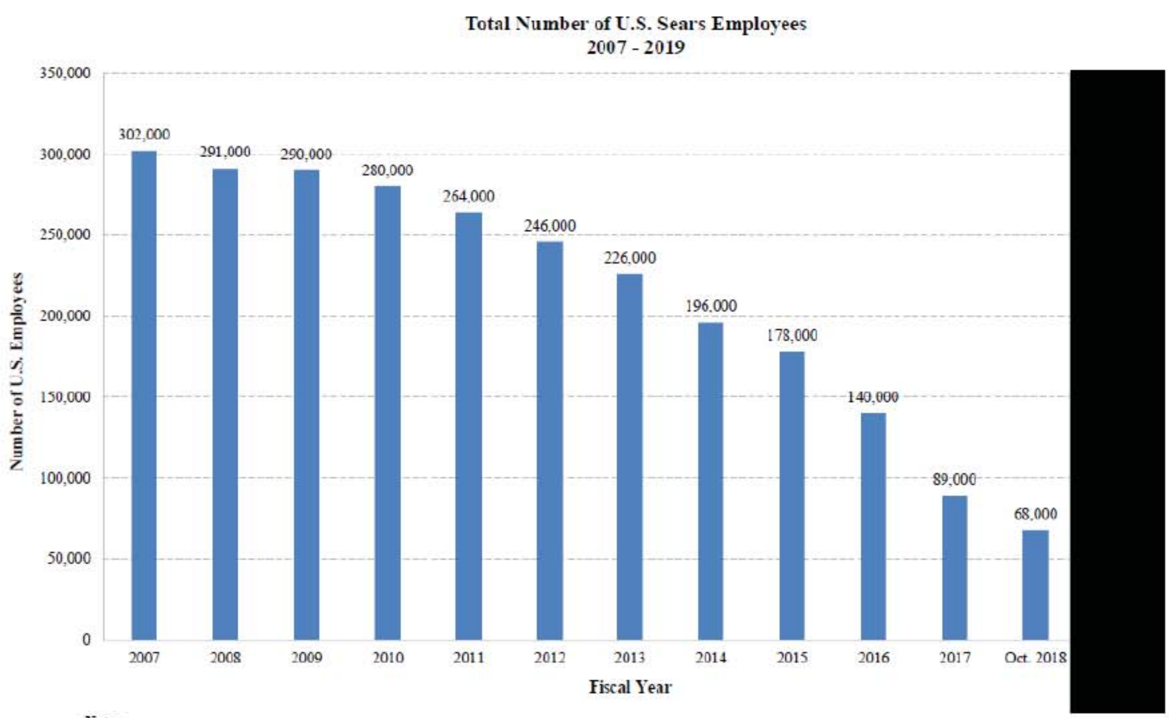
since 2013, [redacted] *Id*. But as evidenced by Sears's dismal performance, none of those initiatives succeeded in reversing Sears's persistent declines in revenue and EBITDAP. Now, Sears NewCo anticipates a 180-degree transformation of Sears's businesses without proposing any actual transformative changes to the company. *Id.* ¶¶ 92-107. Instead, the ESL Business Plan [redacted]

105. For example, the ESL Business Plan places heavy emphasis [redacted]

106. The ESL Business Plan also proposes to [redacted] But Sears has been cutting costs for years, with no corresponding improvements in its revenue or earnings. *Id*. Such drastic cuts, moreover, may be difficult to achieve and may not live up to expectations. *Id.* ¶ 70. Even if these cuts are attainable, they are virtually impossible to achieve without causing significant reductions in sales and gross margin. *Id*. ¶¶ 70-71.

107. The ESL Business Plan also envisions [redacted]

108. Sears has been projecting for years that its fortunes will turn around, and every year it has been very wrong. There is no reason to think that this time is any different. And while Sears has touted its 45,000 employees as a reason to avoid a liquidation, there is every indication that this "new" plan will fail to provide stability, and Sears NewCo will continue to shed employees going forward, if it survives at all. *Id.* ¶ 112 & Ex. 24. Indeed, the number of U.S. Sears employees has dropped dramatically from 302,000 in 2007 to only 68,000 as of October 2018, as shown in the chart below.



Note:
[1] The number of U.S. employees includes all full-time and part-time employees in the United States and U.S. territories for subsidiaries of Sears Holdings Corporation.

109. [redacted]. [redacted] would lead to thousands of Sears employees losing their jobs, in addition to those that have lost their jobs since Sears filed for bankruptcy [redacted]

110. Finally, compounding the uncertainties inherent in ESL's Business Plan is the fact that Sears NewCo is a newly formed entity,[41] likely with very little (if any) assets prior to consummation of the ESL Sale. None of the obligations of Buyer under the APA, including post-Closing obligations to pay Cure Costs and assume liabilities, are guaranteed or backstopped by ESL Investments Inc. (or any other entity). Simply put, no basis exists upon which to conclude that Buyer will be able to satisfy the obligations it purportedly is assuming or provide adequate assurance of future performance under assumed leases and contracts. The ESL Business Plan offers no viable go-forward strategy and renders the ESL Sale non-actionable.

2. The Debtors Cannot Demonstrate Adequate Assurance of Future Performance Under Bankruptcy Code Section 365(b)

111. As a result of the deficiencies in the ESL Business Plan, the Debtors and ESL have not satisfied their burden of providing adequate assurance of future performance under the

[41] According to Delaware's Division of Corporations, the Buyer—Transform Holdco LLC—was formed on September 28, 2018. See https://icis.corp.delaware.gov/ecorp/entitysearch/NameSearch.aspx.

leases to be assumed and assigned in connection with the ESL Sale. Bankruptcy Code section 365(b)(1)(C) requires that in order to assume and assign any unexpired lease or executory contract, a debtor must provide, among other things, "adequate assurance of future performance" under the lease or contract. 11 U.S.C. § 365(b)(1)(C); *In re Embers 86th St., Inc.*, 184 B.R. 892, 902 (Bankr. S.D.N.Y. 1995) (holding that the debtor bears the burden of showing that the requirements for assumption under Bankruptcy Code section 365 have been met).[42] Congress's intent in imposing adequate assurance as a condition on the ability of the debtor to assume a contract was "to insure that the contracting parties receive the full benefit of their bargain if they are forced to continue performance." *In re Ionosphere Clubs, Inc.*, 85 F.3d 992, 999 (2d Cir. 1996); *In re Natco Indus., Inc.*, 54 B.R. 436, 440-41 (Bankr. S.D.N.Y. 1985) ("[T]he obvious purpose of this section, particularly in light of the statutory voiding of bankruptcy default clauses contained in [Bankruptcy Code section] 365(e)(1), is to afford landlords with a measure of protection from having to be saddled with a debtor that may continue to default and return to bankruptcy.").

[42] The term "adequate assurance" is not defined in the Bankruptcy Code, but courts have determined that "[w]hether 'adequate assurance of future performance' has been provided is determined by the facts and circumstances of each case." *In re M. Fine Lumber Co.*, 383 B.R. 565, 572 (Bankr. E.D.N.Y. 2008) (citations omitted). In determining whether a contract counterparty is adequately assured, courts apply a facts and circumstances test and look to a non-exclusive list of factors, including, among other things: (i) the debtor's payment history; (ii) the extent and history of defaults; (iii) the presence of a guarantee and/or a security deposit; (iv) evidence of profitability; (v) a plan with earmarked funds exclusively for the landlord; (vi) the general outlook in the debtor's industry; and (vii) whether the lease is at or below the prevailing market rate. *Androse Assocs. of Allaire, LLC v. Great Atl. & Pac. Tea Co. (In re Great Atl. & Pac. Tea Co.)*, 472 B.R. 666, 675 (S.D.N.Y. 2012); *see In re M. Fine Lumber*, 383 B.R. at 573-74 (collecting cases). Moreover, Bankruptcy Code section 365(b)(3), "imposes heightened restrictions on the assumption and assignment of leases for shopping centers . . . to protect the rights of the lessors and the center's other tenants," *In re Joshua Slocum Ltd.*, 922 F.2d 1081, 1086 (3d Cir. 1990), by requiring additional adequate assurance: "(A) of the source of rent and other consideration due under such lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease; (B) that any percentage rent due under such lease will not decline substantially; (C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and (D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center." *Id.* (citing 11 U.S.C. § 365(b)(3)).

112. Courts have found adequate assurance of future performance in a number of different circumstances, generally when the facts of the case indicated that the contract counterparty was insulated from some measure of risk by improved performance of the lessee or some other security. *See In re Westview 74th St. Drug Corp.*, 59 B.R. 747, 755 (Bankr. S.D.N.Y. 1986) (finding that adequate assurance was sufficient where the debtor increased sales, reduced operating expenses, and provided two months' security); *In re Lafayette Radio Elecs. Corp.*, 9 B.R. 993, 1000 (Bankr. E.D.N.Y. 1981) (court previously held that debtor's sublease program, together with a proposed merger, provided adequate assurance; court further found that proposed sublessee had a likelihood of success and that the $10,000 security deposit, $10,000 promissory note and value of the sublease to the debtor was sufficient). By contrast, courts have held that a debtor's history of financial losses, if not contradicted with evidence of future profitability, may preclude a finding of adequate assurance. *See, e.g.*, *In re DWE Screw Prods., Inc.*, 157 B.R. 326, 332 (Bankr. N.D. Ohio 1993) (denying assumption of lease where debtor's "collective disbursements exceed[ed] receipts" and "monthly expenses extrapolated over an annual basis exceed[ed] Debtor's gross [annual] sales"); *see also In re RS Legacy Corp.*, 2015 Bankr. LEXIS 2206, at *3 (Bankr. D. Del. June 25, 2015) ("[T]he concept of adequate assurance is a flexible one, mainly requiring evidence satisfactory to the Court that the proposed assignee possesses the financial wherewithal to perform all of the obligations under the agreement at issue.").

113. Here, adequate assurance of future performance is clearly lacking as neither ESL nor the Debtors have established that Buyer or Sears NewCo intends to perform, or is capable of performing, under the assumed contracts and leases after Closing. The ESL Business Plan is built on faulty and unrealistic assumptions that leave contract counterparties with no assurance that there will be sufficient free cash flow to avoid financial distress in the near future. *In re*

Natco, 54 B.R. at 440-41. Specifically, as discussed herein, the ESL Business Plan is based on the assumption that Sears NewCo will [redacted] ignoring that Sears has not generated positive EBITDAP since 2012 (and, to be precise, has ***lost*** $500 million for each of the last four years). *Id.* ¶ 75 & Ex. 15. As set forth in the Kniffen Report, [redacted]. Neither the Debtors nor ESL can demonstrate that the go forward business will have the financial wherewithal necessary to satisfy the obligations under the assumed leases and contracts. Indeed, the more likely outcome will be that Sears NewCo will continue the longstanding, downward trajectory of divesting assets, cutting jobs and losing money.

114. Moreover, aside from the doubtful ability of Sears NewCo to fulfill the obligations under the assumed contracts and leases, the terms of the APA create additional uncertainty. The APA sets forth a construct of "designatable leases" and "additional contracts" that allows Buyer to assign such contracts and leases as it wishes to third parties ***after the Closing Date***. This construct leaves contract counterparties without visibility into when, if at all, their obligations may be assumed and rendering it practically impossible to satisfy the requirements of adequate assurance.

115. Specifically, the APA provides Buyer with a 60-day, post-closing Designation Rights Period during which it is not required to pay Cure Costs in respect of "designatable leases" and "additional contracts." *See* APA §§ 2.7(c)-(d); *see also* Proposed Sale Order ¶¶ 29-36. During the Designation Rights Period, Buyer has the right to delay the assumption of any contract or lease and has the option to either not assume any contract or lease (and therefore not pay any liabilities associated therewith, including Cure Costs) or alternatively (as it relates to

leases), ***designate a completely unrelated third party to assume any lease on its behalf***. APA § 1.1 (definitions of "Assignee" and "Designation Rights"), 2.1, 2.6. As the APA contemplates that Buyer will make its determination on whether to designate a third party assignee for such contracts after the approval of the ESL Sale and the Closing Date, the contract counterparties will have no opportunity to object once they learn of the identity of any third party designee. The APA provides no mechanism for these contract counterparties to object after Buyer has made its designation determination.

116. In effect, the APA allows ESL to claim the Debtors' statutory rights (*i.e.*, the right to assume and assign) while sidestepping the concomitant burdens (*i.e.*, the requirement of notice and hearing and adequate assurance of future performance) under Bankruptcy Code sections 363 and 365. Suffice to say, no adequate assurance can be provided as it relates to the performance of unknown, un-identified third parties who may become, in ESL's sole right and determination, assignees under the Debtors' leases and contracts. Under the construct of the APA, counterparties are stripped of their statutory protections while ESL gains another opportunity to monetize valuable assets on its own timeline and for its sole benefit. Accordingly, the lack of adequate assurance violates the express provisions of Bankruptcy Code section 365(b)(1)(C) and precludes the Debtors from assuming and assigning contracts and leases to Buyer.

B. The ESL Sale Will Leave the Estates Administratively Insolvent

117. The ESL Sale fails the Debtors' own litmus test in selecting a successful bid: administrative solvency. Despite consistently expressing the importance of selecting a path that would ensure the Debtors' estates remained administratively solvent, the Debtors constructed their administrative claims analysis by using overly conservative estimates of their liabilities and overly optimistic estimates of their assets left behind by the ESL Sale. Even by the Debtors' own cherry-picked analysis as of the date of the Auction, however, the ESL Sale will render the

Debtors' estates' ***administratively insolvent by*** [redacted]—and that is a ***conservative estimate***.[43] The Debtors nonetheless have decided to accept the ESL Sale through unjustified reliance on potential upsides that they claim could cover that shortfall, while ignoring material risks and downsides.

118. The Debtors' assessment of administrative claims that will remain obligations of the estates is flawed for two principal reasons. ***First***, the Debtors' estimates ignore the Debtors' own cash flow projections, assume certain assets remain with the estates when, in fact, they are sold and omit the [redacted] in accrued post-petition royalties that may be payable to KCD IP, LLC. Accounting for those factors, the estimated administrative shortfall reaches $226 million. ***Second***, the Debtors justified their decision to accept the ESL Bid by citing potential upsides related to the transaction that ***might*** (but might not) cover the shortfall, but fail to adjust for the risk associated with myriad potential downsides—significant downsides that could increase the shortfall materially. Indeed, the Creditors' Committee's financial advisor estimates that, if properly calculated and based on information available, the shortfall in covering the Debtors' administrative expenses after consummation of the ESL Sale could exceed $250 million. *See* Declaration of Matthew Diaz, Managing Director, FTI Consulting, Inc., attached hereto as **Exhibit B** (the "Diaz Declaration").

119. As one of the more egregious examples, ESL cannot demonstrate, or even credibly claim, that the assumed liabilities (purporting to represent hundreds of millions of dollars in value to the estates) will ever be paid because of the doubtful financial wherewithal of Sears NewCo and the illusory nature of assumed liabilities under the APA. Moreover, in light of

[43] Since that time, the Debtors and their advisors have provided information to reduce the amount of this number. Regardless, there is no dispute that there will be a shortfall. For the avoidance of any doubt, the Objection relies on the numbers that were used by the Debtors and their advisors at the time of the Auction.

the highly conditional nature of ESL's obligations even to close the ESL Sale, the Debtors remain at significant risk that ESL could unilaterally terminate the APA and demand the return of its entire $120 million deposit—creating an even bigger strain on the administrative solvency of the estates.

120. In contrast to the risks and dubious assumptions related to the ESL Sale, the asset monetization and wind-down process modeling prepared by the Debtors and the Creditors' Committee shows not only administrative solvency, but also a potential distribution to unsecured creditors. *See infra* Objection, Part IV. Accordingly, the Court should reject the ESL Sale as not in the best interests of the Debtors' estates and their creditors. *See, e.g., In re Flour City Bagels, LLC*, 557 B.R. 53, 80 (Bankr. W.D.N.Y. 2016) (denying the debtor's motion to approve a 363 sale where such sale would leave the debtor's estate with scant value and holding that "[i]n light of the substantial risk that the $1.3 million in cash that Canal offers to pay will render Flour City administratively insolvent, the Court finds that the structure of the sale is not reasonable or supported by a good business justification.").

1. The Debtors' Estimates Discount Their Administrative Shortfall by [redacted]

121. While the ESL Sale purports to provide for the assumption of a substantial portion (but not all) of the Debtors' estimate of administrative expenses, the Debtors' estimates at the time of the Auction fail to account for (i) the Debtors' projected outstanding obligations under the DIP ABL Facility; (ii) assets that are being sold to Buyer and not retained by the Debtors; and (iii) accrued post-petition royalties that may be owed to KCD IP, LLC at the Closing of the ESL Sale. Indeed, as depicted in the chart below (even when using the Debtors' favorable administrative expense estimates), once each of the aspects of the ESL Sale is properly

accounted for, it becomes clear that the transaction will render the Debtors' estates administratively insolvent. Diaz Decl. ¶¶ 20-23.

$ in millions	Debtors' Estimate	Committee's Estimate
Administrative Obligations Not Assumed by ESL		
503(b)(9)	[redacted]	[redacted]
Accounts Payable		
Taxes and Other		
RemainCo Winddown Costs		
ABL DIP		
Total Administrative Claims		**$290**
Sources of Value Left Behind by the Debtors' Estate		
Less: MTN Sale Proceeds	(81)	(81)
Less: Cash at Banks	[redacted]	[redacted]
Less: Store Cash		
Less: Other Cash - Utility Deposit		
Less: Insurance Proceeds		
Less: SHIP Sale Deposit	(6)	(6)
Less: UHAUL Unencumbered Proceeds	(7)	(7)
Potential Additional Post-Petition Obligations		
Add: KCD Royalties	-	[redacted]
Total Potential Administrative Claims Shortfall As Of the Time of the Auction	[redacted]	**$226**

122. While the Debtors' projections at the time of the Auction show approximately [redacted] in outstanding obligations under the DIP ABL Facility as of February 9, 2019, *see* Project Blue, Rolling Cash Flow Budget (Week 13), dated January 17, 2019, at 4, the Debtors have stated that they must "manage down" the obligations under the DIP ABL Facility by another [redacted] to bridge the gap between its projected balance on the date of closing and the cap of $850 million required to satisfy a condition precedent in the APA. *See* APA § 10.10. In order to accomplish these further reductions, the Debtors will have to achieve in part better cash flow than forecasted through a targeted inventory disposition strategy, which, remarkably,

the Debtors acknowledged as imprudent just one day before accepting the ESL Sale. *See* Jan. 15 Auction Tr. 54:8-11 (counsel for the Debtors stating that "managing down" the amount outstanding under the DIP ABL Facility "was not something that we felt was fair or in the company's best interest to take that risk"). By taking into account actual cash flow results that do not depend on simply "managing down" obligations under the DIP ABL Facility, the Debtors' estimate of the administrative shortfall should be higher. Diaz Decl. ¶ 21.

123. In addition, at the time of the auction, the Debtors assumed they would be able to retain [redacted] in proceeds from utility deposits. However, section 2.1 of the APA, which concerns the assets to be acquired in connection with the ESL Sale, provides that Buyer, not the Debtors, would retain any such security deposits. APA § 2.1(o). Accordingly, the Debtors' administrative claims shortfall estimate should be increased by [redacted]. Diaz Decl. ¶ 22.

124. Lastly, the Debtors' administrative solvency analysis does not account for the accrued post-petition royalties that may be due to KCD IP, LLC as of the Closing Date. Under the applicable license agreements, the Debtors are obligated to pay royalty payments related to selling products with intellectual property owned by KCD IP, LLC, including for the use of Kenmore and DieHard trade names and other intellectual property. If payable, those royalty payments are projected to be approximately [redacted] by the Closing Date. The Debtors have not paid these royalties since the Petition Date, meaning the entire [redacted] may be due upon Closing. The Debtors, however, do not take into account these potential obligations in their solvency analysis.[44] Diaz Decl. ¶ 23.

[44] As noted in the Diaz Declaration and explained in further detail below, the "Cash at Banks" amount of [redacted] assumes the cash is free of all liabilities and readily available, which may not be the case. Diaz Decl. ¶ 33.

2. The Debtors' Analysis Relies on Potential Upsides, but Fails To Account for Significant Downsides that Would Increase Administrative Expenses

125. Exacerbating the administrative insolvency evident in the Debtors' own analysis are numerous downside risks the Debtors essentially ignore while taking into account potential upsides that *might* cover the administrative shortfall. The potential upsides the Debtors consider include inventory not being sold to Buyer (estimated to be approximately [redacted]), the value of inventory and receivables in excess of $1.657 billion (if any), reducing accounts payable and favorable budget to actual results to the Debtors' cash flow budget.

126. The Debtors, however, fail to factor in significant potential downsides to the ESL Sale. As explained below, these downsides threaten the Debtors' liquidity position even further.

- **The Debtors Are Contractually Obligated To Incur Additional Administrative Expenses After the Closing, which they Have No Ability To Pay.** Under the APA, Buyer has no obligation to disclose which contracts and leases it intends to assume at Closing until two business days prior to the Closing Date. *See* APA § 2.7(b)(ii). Moreover, Buyer has the right, for up to 60 days following the Closing Date (but no later than May 3, 2019) (the "Designation Rights Period"), to designate those leases and contracts it wishes to assume. *See id*. §§ 2.7(c) and (d), 2.9, 5.2. As such, there is no obligation for Buyer to assume any contract or lease (or any liability associated therewith) for the entirety of the Designation Rights Period, if at all, and no visibility as to which contracts and leases may be subject to this delayed assumption period until two business days prior to the Closing Date. Moreover, the costs and expenses incurred during the Designation Rights Period (which, at its extreme, could include costs and expenses associated with all of the Debtors' existing leases and contracts) are liabilities of the Debtors—and not Buyer. This shifting of liability (from Buyer to the Debtors) post-Closing may result in the Debtors incurring additional administrative expenses after the Debtors have sold substantially all their assets to Buyer. Further, Buyer has no obligation to pay any compensation to the Debtors under the occupancy agreement or the APA for use of the leases and is solely obligated to pay (or reimburse) the Debtors for expenses incurred in connection with the leased premises, *See id*., Ex. D (Form of Occupancy Agreement) §§ 4-5. It remains to be seen how the Debtors can pay *any* expenses on account of any contract or lease following the Closing Date.

- **The Debtors Will Be Liable for Accrued Payroll Obligations through Closing.** Under the APA, Buyer does not assume the liability of payroll obligations until the anticipated closing date of February 9, 2019. APA §§ 2.4(f), 9.7(b). Diaz Decl.¶ 31. Therefore, the Debtors are liable to pay all accrued but unpaid payroll

obligations until the sale closing date. The Debtors' own Cash Flow Budget demonstrates that approximately [redacted] in payroll, taxes, and benefits are due to be paid out during the week of February 16, 2019, meaning that they would have accrued as of the previous week (*i.e.*, the week ending February 9, 2019). The Debtors have not accounted for these payroll liabilities in their administrative claims estimates.

- **The Debtors Will Be Liable for Warranties and Protection Agreement Liabilities for an Unknown Period.** Under sections 2.3(e) and 2.8(e) of the APA, the Debtors will remain obligated on warranty and protection agreement liabilities unless and until the KCD Notes, which are debt obligations of non-Debtor KCD IP, LLC owed to non-Debtor Sears Reinsurance Company Ltd. ("Sears Re"), are transferred to Buyer. Diaz Decl. ¶ 32. In order to transfer the KCD Notes, Sears Re must first obtain consent form the Bermuda Regulatory Authority, and the timing of that consent and subsequent transfer is uncertain. Until the transfer is complete, Buyer will service the warranty claims and protection agreements, and the Debtors will reimburse Buyer for the costs. APA §§ 2.3(e), 2.8(e). Historically, Sears Re has reimbursed the Debtors for the costs of servicing the warranties and protection agreements but has ceased remitting reimbursement since the Petition Date. The costs of servicing these agreements is approximately [redacted] per month, and the Debtors' estimates do not account for reimbursement to Buyer for these costs.

- **The Debtors' Cash May be Restricted.** The Debtors estimate they have approximately [redacted] in cash at banks remaining after the ESL Sale Closing. Diaz Decl. ¶ 33. However, even the Debtors' most recent analysis acknowledges the risk of recovering the full amount and places a [redacted] percent risk on these proceeds. To the extent any of the Debtors' cash is not readily available for use, the Debtors' administrative shortfall will grow.

- **The Debtors May Not Be Able to Retain the SHIP Deposit.** The Debtors' estimates currently assume that they will be able to retain the $6 million received from Service.com in connection with the termination of the SHIP Purchase Agreement. *See* APA §§ 2.1(z), 2.2(p). The Creditors' Committee understands, however, that Service.com may contest the Debtors' termination of the SHIP Purchase Agreement and the Debtors' entitlement to retain the $6 million deposit. If the Debtors are not permitted to retain the $6 million deposit, there would be a dollar for dollar increase in the Debtors' administrative insolvency. Diaz Decl. ¶ 34.

- **The Debtors Remain Liable for Mechanics' Lien Obligations**. There is approximately $4 million in mechanics' liens alleged or asserted against the Debtors' estates. While ESL's counsel stated during the Auction that ESL would assume these obligations, *see* Jan. 15 Auction Tr. 72:22-23, the executed APA considers those lien obligations to be excluded liabilities. APA § 2.4(r). Buyer has not agreed to assume these mechanics' liens, and therefore, the Debtors' administrative shortfall will increase. Diaz Decl. ¶ 35.

- **Any Delay in Closing the ESL Sale Will Cause the Debtors To Incur Substantial Costs.** The Debtors' estimates and analysis are entirely dependent upon ESL being able to close the proposed sale on February 9, 2019. However, as described in further detail *supra*, there is significant uncertainty surrounding ESL's ability to close on time. This uncertainty includes, but is not limited to, ESL's ability to demonstrate adequate assurance of future performance to contract and lease counterparties and matters pertaining to the completion of the marketing period for the ESL's financing as well as any appeals that may be filed in the event the ESL Sale is approved. In the event that ESL is unable to close by February 9, 2019, then the Debtors' estates will be saddled with even larger administrative costs of [redacted] per day based on the Debtors' estimates. Diaz Decl. ¶ 36.

- **The Debtors May Experience Unfavorable Budget to Actual Variances.** In addition, due to the uncertainty inherent in the ESL Sale and the Debtors' go-forward path, it is quite possible that the Debtors will experience unfavorable budget to actual variances. Diaz Decl. ¶ 37.

- **The Debtors Remain Liable for "Assumed" Liabilities.** ESL purports to provide for the assumption of numerous liabilities, including all of the Debtors' 503(b)(9) Claims and Other Payables, as listed on Schedule 1.1(g) of the APA. APA § 2.3(k). Disturbingly, however, the APA and Proposed Sale Order contain provisions that put the Debtors at risk of never actually being relieved of these administrative and priority claims, which eventuality is all the more likely given Sears NewCo's razor thin financial margins. APA §§ 2.3(k)(x). In this event, the Debtors will be left with significant additional administrative claims (which were contemplated to be assumed in connection with the ESL Sale), but without any ability to satisfy those claims. Diaz Decl. ¶ 40.

- **Assumed Liabilities Are Capped and Subject to Significant Reduction.** The APA caps the assumption of liabilities and, therefore, leaves the Debtors with significant unpaid administrative expenses (even if the purportedly assumed obligations are actually paid by Buyer or Sears NewCo) through the imposition of caps. Specifically, severance is capped at $43 million; 503(b)(9) Claims are capped at $139 million, despite estimates that these claims will total $173 million ***at the very least***; and Other Payables are capped at $166 million. *Id.* With respect to 503(b)(9) Claims and accounts payable, the APA does not identify which of such obligations will be assumed and which will remain the Debtors' responsibility. Under Sections 2.3(k)(vii)-(ix) of the APA, if the value of certain current assets (specified receivables, warranty receivable and prepaid inventory) is lower than the dollar value that ESL set forth in the APA, thus resulting in a working capital "shortfall," then the amount of liabilities Buyer has agreed to assume related to severance, 503(b)(9) Claims and accounts payables will be reduced dollar-for-dollar by the shortfall amount. *Id.* In such an event, the administrative claims shortfall would increase. In fact, as of January 23, 2019, the Debtors' estimate for warranty receivables and prepaid inventory are barely in excess of the targets set forth in the APA. Because payments on some of these

claims are not due until 120 days following the Closing or the date of confirmation, if Buyer fails to meet assumed obligations, recourse regarding 503(b)(9) Claims and other administrative and priority claims will remain at the Debtors' estates. Diaz Decl. ¶¶ 38-40.

- **Assumed Liabilities, Including 503(b)(9) Claims and Severance Obligations, Are Subject to Further Reduction if There Is a "DIP Shortfall."** The APA provides that Buyer's obligations to assume liabilities shall be reduced (dollar for dollar) to the extent that the "Aggregate DIP Shortfall Amount" is a ***positive*** number. APA § 2.3(k)(vi). The Aggregate DIP Shortfall Amount is defined as "an amount equal to $1,200,000,000 less the aggregate amounts required to be paid (net of any available cash) to fully satisfy the existing indebtedness of Sellers under both (i) the DIP Credit Agreement and (ii) the Junior DIP Term Loan Agreement. *Id.* § 1.1 (definition of "Aggregate DIP Shortfall Amount"). Under the plain language of the APA, the Debtors are penalized for incurring less indebtedness under its DIP facilities **as *every dollar under $1.2 billion that the Debtors do not need to repay under its DIP facilities reduces the amount of assumed liabilities that Buyer is obligated to pay***. Diaz Decl. ¶¶ 38-40.

- **The Debtors Are Responsible for Liabilities Regarding Employee Benefits.** Pursuant to section 9.7(j) of the APA, the Debtors remain responsible for the medical, dental, and health claims of eligible employees for services rendered prior to the Closing. Because the majority of the Debtors' medical plans are self-insured, it is not unusual for such benefit-related claims to lag as a result of delays in processing. According to the Debtors' first day wage motion, they had approximately $19.1 million in employee benefit liabilities, which is an appropriate proxy for estimating this liability as of the Closing. Diaz Decl. ¶¶ 40.

- **Payments of Cure Costs Are Delayed.** Buyer is not required to pay Cure Costs in respect of "designatable leases" or "additional contracts" unless and until it decides to assume these leases and contracts, which could be throughout the entirety of the 60-day Designation Rights Period. *See id.* §§ 2.7(c)-(d). As such, there is no guarantee that Buyer will pay any of the purported $200 million of Cure Costs at estimated by the Debtors at Closing.

- **The Debtors May Be Required To Pay for Transition Services, Including Professional Fees.** Under the APA, the Debtors are required to use reasonable best efforts to agree to and execute a transition services agreement pursuant to which Sellers provide to Buyer (and vice versa) "certain services for a transitional period following the Closing." APA § 8.8(a).[45] The duration and extent of these

[45] Section 8.8(b) of the APA requires the applicable Seller, for a period of up to six months after the Closing, to remain the manager, controller or operator of each Acquired Property, Occupancy Leased Premise and Sparrow Property solely to the limited extent required for any Permit applicable to such Acquired Property, Occupancy Leased Premises or Sparrow Properties to remain effective. Sellers appoint Buyer as their agent to manage, control and operate each of such properties. Buyer has the right to receive all revenues produced by such properties. Seller has no right to such revenues and only has the right to reimbursement of reasonable and documented out-of-pocket

transition services, and the attendant costs to the Debtors associated therewith (and whether such costs will be ultimately borne by Debtors' estates or Buyer) is unknown. Unless Buyer agrees to pay ***100 percent of the costs (including professional fees)*** associated with the Debtors' ongoing servicing requirements, such costs, along with the additional amounts associated with prosecuting a contested ESL Sale, will further increase the Debtors' administrative insolvency. Similarly, the Debtors are required to remain as the manager or operator under certain leased properties for a period of up to six months after the Closing to allow Buyer time to obtain requisite permits. *See id*. § 8.8(b). As such, the Debtors assume the significant risk that Buyer will fail to pay operating expenses, operate the premises and reimburse the Debtors for acting as manager, made all the less likely by the razor thin liquidity of the ESL Business Plan. Moreover, as set forth further in the Diaz Declaration, the Creditors' Committee estimates even further administrative burn, resulting from the staggering daily operational losses of at least [redacted]. *See* Diaz Decl. ¶ 36.

127. In isolation or taken together, these significant downside risks to the ESL Sale expose the Debtors to unjustified and unreasonable expenses that, after consummation of the ESL Sale, it will not have the ability or assets to satisfy.

128. In short, an analysis that properly estimates the administrative shortfall and factors in potential upsides as well as downsides to the ESL Sale demonstrates an administrative insolvency increase, as shown in the following chart based on the more accurate administrative claims shortfall reached by the analysis described herein.

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costs, fees and expenses incurred in providing the management services, including any income and other taxes incurred by Seller in respect of the payment and receipt of such reimbursement. Buyer will also indemnify Sellers from any Liability arising from the provisions of the Management Services.

$ in millions	**Committee's Estimate**
Total Potentail Administrative Claims Shortfall As Of the Time of the Auction	$226
<u>**Potential Upsides**</u>	
1. Inventory Not Being Sold to ESL	[redacted]
2. Value from Credit Bid Release Consideration Reserve	(35)
3. Value from Excess Inventory and Receivables	tbd
4. Reduced Accounts Payable	tbd
5. Historical Favorable Budget to Actual Variance	tbd
Total Potential Administrative Claims Shortfall Considering Only Potential Upsides	**$148 - tbd**
<u>**Potential Downsides**</u>	
6. Accrued Payroll Due at Closing	[redacted]
7. Warranties and Protection Agreements Liabilities	
8. Loss of Cash at Banks	
9. Loss of the SHIP Deposit	6
10. Mechanics' Lien Obligations	4
11. Cost of Closing Delays	tbd
12. Unfavorable Budget to Actual Variances	tbd
13. Unfavorable 503(b)(9) Claims	tbd
14. Working Capital Adjustments	tbd
15. Liabilities Remaining With the Debtors	tbd
16. Liabilities regarding Employee Benefits	tbd
Total Potential Administrative Claims Shortfall Considering Both Potential Upsides and Downsides	**$259 +/- tbd**

129. The ESL Sale fails to clear the crucial hurdle of administrative solvency. Not only does the Debtors' own analysis of the administrative claims reveals that the ESL Sale will produce a shortfall, the Debtors have not taken into account the numerous potential downsides that would accompany the ESL Sale. *See* Diaz Decl. ¶¶ 31-42. Given that the asset monetization and GOB process modeling prepared by the Debtors and the Creditors' Committee shows that all administrative claims would be paid and provide recoveries to unsecured creditors, the Debtors' decision to accept the ESL Bid cannot be sustained as in the best interests of the Debtors' estates and their creditors. *See, e.g.*, *In re Flour City Bagels*, 557 B.R. at 80. The

significant administrative insolvency risk attendant to the ESL Sale alone precludes a finding that the Debtors exercised sound business judgment by accepting the ESL Bid.

3. The APA Contains Numerous Conditions that May Prevent the ESL Sale from Closing—Putting an Even Greater Strain on the Estates

130. Moreover, the Debtors may be footing the bill for the above downsides without receiving any value from ESL because the ESL Sale may never close. The APA is fraught with execution risk due to the highly conditional nature of Buyer's obligation to close. Specifically, the APA contains a number of conditions, many of which are both unlikely to occur by the required deadline (often the Outside Date) and/or entirely out of the Debtors' control. In the event the ESL Sale does not close by the Outside Date of February 19, 2019 (the likelihood of which is significant in view of the numerous conditions precedent and other execution risk factors), ESL is entitled—in virtually all circumstances—to terminate the APA and receive a refund of its entire $120 million deposit.

131. Set forth below is a list of certain of the closing conditions contained in the APA that are outside of the Debtors' control, and which very well may result in an inability to close the transaction by the Outside Date.

- **Sale of Non-Debtor Assets.** The APA provides for the sale of assets by non-Debtors to Buyer or otherwise makes the assumption of certain liabilities contingent on such non-Debtor asset sales.
    - Section 2.1(e): provides for the sale of all Intellectual Property including Intellectual Property that is owned by non-Debtors such as the Kenmore Marks and the DieHard trade names, which are owned by KCD IP, LLC (collectively with all Intellectual Property owned by KCD IP, LLC, the "<u>KCD IP</u>"). Alternatively, section 9.14 of the APA enumerates a number of options for the Debtors to enable Buyer to gain access to the use of the KCP IP based on the consents of non-Debtors (including, potentially, PBGC). Among the options are the Debtors' assumption of all KCD Agreements and the grant of a perpetual sublicense to Buyer. Yet, the Debtors cannot assume the KCD Agreements, as they eventually will be wound down following the consummation of the ESL Sale. Failure to

transfer the KCD IP to Buyer or satisfy the conditions of section 9.14, would enable ESL to terminate the APA and obtain its deposit.

- Section 2.1(r): requires non-Debtor Sears Re to sell the KCD Notes to Buyer, absent which, Buyer will not assume the PA Liabilities.[46] The KCD Notes cannot be transferred until the Bermuda Monetary Authority, which has jurisdiction over Sears Re, consents to the transfer of these items. As a result, the transfer of the KCD Notes and protection agreement liabilities may be delayed, potentially indefinitely. Until the consent is obtained, Seller is required to continue to hold the protection agreement liabilities, and Buyer will service those liabilities under a servicing agreement. The cost for the servicing is the amount of royalties that Buyer would be paying under the KCD IP license. There is no indication that the value of the servicing is equivalent to the royalty payments. Additionally, Sellers have additional incremental expense and liability exposure while they are holding these assets. *See id.* § 2.8(e). This requirement is also an ESL closing condition and presents significant execution risk for Seller. Specifically, ESL could determine that Seller did not use its reasonable best efforts to obtain one of these items and terminate the APA. As noted *supra*, it remains unclear how Seller can cause KCD to take such actions, or encumber the Kenmore and DieHard intellectual property, without KCD IP LLC's (and, potentially, PBGC's) consent or grant a perpetual sublicense when Sellers soon will cease to exist. Moreover, there is concern that the exclusive license ESL is requiring in respect of the KCD IP has so many indicia of full ownership that the grant may constitute a disposition of the KCD IP. *See id.* §§ 9.14, 10.8.

- Section 2.1(s): requires non-Debtor SRC Sparrow 2 LLC to sell its equity interests in non-Debtor SCR O.P. LLC to Buyer.

- **Completion of Marketing Period for ESL's Financing.** Section 4.1 of the APA provides that the Closing is conditioned upon expiration of a marketing period for ESL's financing. If the marketing period has not ended at the time that the conditions set forth in Article X and Article XI have been satisfied or waived, then the Closing cannot occur until the earlier of (x) any Business Day as may be specified by the Buyer on no less than two (2) Business Days' notice or (y) two (2) Business Days following the final day of the marketing period. As such, if the marketing period is interrupted and the Closing is delayed, the Closing may not occur before the Outside Date, and in turn, ESL would have a right to terminate the APA and receive a refund of its \$120 million deposit. *See id.* § 4.1.

[46] "PA Liabilities" are all Liabilities for warranties and protection agreements or other services contracts (other than warranties relating to Intellectual Property) for the good and services of Sellers sold or performed prior to the Closing, including any Liabilities owed by Sears Re to any Sellers in respect of reinsurance of such warranties and protection agreements. APA § 2.3(e).

- **Inability to Deliver Documents.** Section 4.3 of the APA requires the delivery to Buyer of a variety of agreements and documents in order to consummate the transactions contemplated by the APA. Those agreements include documents required by ESL's lenders (which, upon information and belief, had not been disclosed to Sellers as of the execution date of the APA) and significant records for all intellectual property being acquired pursuant to the APA. It may not be possible for Sellers to obtain all of these documents by the Outside Date, which would give ESL the right to terminate the APA and receive a return of its deposit. *See id*. § 4.3.

- **Value of Acquired Assets/Maximum Liabilities.** Article X of the APA sets forth numerous conditions to ESL's obligation to close (certain of which are also noted *supra*) that give ESL significant leeway to walk away from the transaction without recourse (and ESL would receive a refund of its $120 million deposit), including, most significantly: (i) the aggregate value of the acquired inventory and accounts receivable must be at least $1.657 billion; (ii) the outstanding indebtedness under the DIP ABL Facility shall be no greater than $850 million; and (iii) the outstanding indebtedness under the Junior DIP Facility shall be no greater than $350 million. Sellers' projections indicate that it will be a challenge to meet these inventory and receivables thresholds as well as the DIP balance thresholds. *See id.* §§ 10.9, 10.10.

- **Milestones.** ESL can terminate the APA and receive a refund of its $120,000,000 deposit in the following circumstances, among others: (i) the ESL Sale has not closed by February 19, 2019 (*See id.* § 12.1(a)(ii)); or (ii) if the Court has not approved the transactions or the sale order is not obtained (or is vacated or stayed) by February 8, 2019. *See id.* § 12.1(b)(ii).

132. Indeed, the Debtors are only permitted to retain the $120 million deposit if the APA is terminated by the Debtors due to ESL's breach of a representation and warranty or if the Debtors are ready, willing and able to close but ESL chooses not to close the transactions. Indeed, under the terms of the ESL Sale, ESL's maximum liability as a result of the termination of the APA by the Debtors because of ESL's conduct, ***even in cases of willful and material breach***, is the loss of the Deposit. *See id.* § 12.2.

133. In other words, given its significant conditionality, ESL could unilaterally decide to terminate the APA, collect its $120 million deposit and leave the Debtors holding the bag for the substantial administrative liabilities they continue to accrue in a sale process being conducted at ESL's request and for its benefit.

134. Given the infirmities described above, the ESL Sale fails to achieve the highest and best option for the Debtors' estates.

III. THE ESL SALE IMPERMISSIBLY PERMITS ESL TO CREDIT BID AND GRANTS ESL A RELEASE FOR INADEQUATE CONSIDERATION

135. As explained in detail in the Standing Motion and Proposed Complaint and summarized herein, Sears's downfall was precipitated, in large part, by years of self-dealing, breaches of fiduciary duties, abuses of control and undue influence by the hopelessly conflicted Lampert and ESL. ESL and Lampert managed Sears as if it were a private portfolio company that existed solely to provide the greatest returns on their investments, recklessly disregarding the damage to Sears, its employees, and its creditors. They have diverted Sears's assets for their own benefit (and with no benefit to Sears) at a time when Sears was insolvent and saddled Sears with purported "debt" obligations that would never—and could never—be paid back. ESL is now attempting to use this "debt" as currency to buy Sears's valuable assets.

136. In connection with the ESL Sale, the Debtors agreed to permit ESL to credit bid $1.3 billion in allegedly secured claims (the "Credit Bid Claims") and otherwise allow all of the ESL Claims even though such claims are disputed. To facilitate this credit bid, the APA provides ESL and related entities with a powerful and extremely valuable release, which is premised upon the waiver of viable and valuable causes of action and remedies that is far broader than is necessary to effectuate the credit bid contemplated by the ESL Sale. As set forth in detail in the Standing Motion and Proposed Complaint, the Creditors' Committee has gathered substantial factual support for causes of action that, if litigated, have the potential to return hundreds of millions in value to the Debtors' estates through the recharacterization, equitable subordination and/or disallowance of the ESL Claims as a remedy for years of wrongdoing perpetrated by Lampert and ESL against the Debtors and their stakeholders—and yet the

Debtors' propose to release and neutralize any such actions and allow all of the ESL Claims[47] for only the $35 million in Release Consideration and "other good and valuable consideration provided to the Debtors and their estates by ESL in connection with the Transactions." APA § 9.13(a); *see also* Proposed Sale Order ¶¶ 7(a)-(d). The "other good and valuable consideration" is worthless as it is unidentified, unvalued or otherwise would have been paid in connection with Sears's wind-down.[48]

137. By accepting the ESL Bid to acquire Sears, made in large part through a credit bid of hotly disputed claims, the Debtors—led by Board members who were handpicked by and beholden to Lampert and ESL—have capitulated to Lampert's and ESL's efforts to control the

[47] Section 9.13 of the APA provides, in relevant part:

> (b) Effective upon the Closing, ESL's Claims against the Debtors arising under (i) the IP/Ground Lease Term Loan Facility; (ii) the FILO Facility; (iii) the Real Estate Loan 2020; (iv) the Second Lien Term Loan; (v) the Second Lien Line of Credit Facility; (vi) the Second Lien PIK Notes and (vii) the Citi L/C Facility (together with the any security interests securing any of the Claims described in the preceding sub-clauses (c)(i)-(vi), collectively, the "ESL Claims") shall each be deemed allowed for all purposes in the Bankruptcy Cases and under the Bankruptcy Code in the amounts set forth on Exhibit G, as reduced by the credit bid set forth in Section 3.1(b).
>
> (c) After giving effect to the credit bid set forth in Section 3.1(b), ESL shall be entitled to assert any deficiency Claims, Claims arising under Section 507(b) of the Bankruptcy Code, or other Claims and causes of action that it may have against the Debtors and their estates in the Chapter 11 Cases, provided that (i) no Claims or causes of action of ESL shall have recourse to, or any other right of recovery from, any Claims or causes of action of the Debtors or their estates related to Lands' End, Inc., the "spin-off" (as such term is defined in the Information Statement of Lands' End, Inc. dated March 18, 2014), Seritage Growth Properties, Inc., Seritage Growth Properties, L.P., the "Transaction" (as that term is defined in the registration statement on Form S- 11 filed by Seritage Growth Properties, which registration statement became effective on June 9, 2015), any Claim or cause of action involving any intentional misconduct by ESL, or the proceeds of any of the foregoing, (ii) any ESL Claims arising under Section 507(b) of the Bankruptcy Code shall be entitled to distributions of not more than $50 million from the proceeds of any Claims or causes of action of the Debtors or their estates other than the Claims and causes of action described in the preceding clause (c)(i); provided that, in the event that, in the absence of this clause (c)(ii), any such proceeds to the Debtors or their estates would have resulted in distributions in respect of such ESL Claims in excess of $50 million, the right to receive such distributions in excess of $50 million shall be treated as an unsecured claim and receive pro rata recoveries with general unsecured claims other than the Claims and causes of action described in the preceding clause (c)(i), and (iii) notwithstanding any order of the Bankruptcy Court to the contrary or section 1129 of the Bankruptcy Code, it shall not be a condition to confirmation of any chapter 11 plan filed in the Bankruptcy Cases that any ESL Claims arising under Section 507(b) of the Bankruptcy Code be paid in full or in part.

APA § 9.13(b), (c).

[48] Moreover, to the extent it purports to include the "assumption" of liabilities, such value is illusory given that the only remedy provided by the APA and Sale Order is a general unsecured claim by the applicable Debtor against a shell entity (Buyer). *See supra* Objection, Part II.B.

remaining assets of Sears and deprive these estates and their unsecured creditors of any chance of a recovery on account of colorable and very valuable causes of action against Lampert and ESL. As explained below, the Debtors' acceptance of only $35 million for the release of these valuable causes of action cannot possibly be the product of good business judgment, much less survive the heightened scrutiny that necessarily applies to a release of causes of action against the Debtors' insiders. The credit bid is further fundamentally flawed because it is being used to acquire assets that are not collateral for the Credit Bid Claims.

A. The ESL Claims Are Disputed Claims and Cannot Be Allowed for Credit Bidding Purposes or Otherwise

138. As set forth in the Standing Motion, Proposed Complaint and the ESL Claims Objection, the Creditors' Committee has identified facts to support causes of action against Lampert and ESL and bases to object to the ESL Claims that are not only colorable, but also extremely valuable, even after accounting for litigation cost, risk and delay. These causes of action are founded in recharacterization, equitable subordination and fraudulent conveyance. Allowing the ESL Claims, including the Credit Bid Claims, in connection with the credit bid for the Acquired Assets is inconsistent with applicable law.

139. Bankruptcy Code section 363 permits the holder of an ***allowed*** secured claim to credit bid the amount of such claim when the underlying collateral is sold outside the ordinary course of business. Specifically, section 363(k) provides:

> At a sale under subsection (b) of this section of property that is subject to a lien that secures an ***allowed*** claim, ***unless the court for cause orders otherwise*** the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. § 363(k) (emphasis added). The decision of whether to allow or deny (for cause) a credit bid is within the discretion of the bankruptcy court, and the court has the flexibility to

fashion an appropriate remedy on a case-by-case basis. *In re Aeropostale, Inc.*, 555 B.R. 369, 415 (Bankr. S.D.N.Y. 2016) ("The term 'cause' is not defined by the Bankruptcy Code, and it is left to the court to determine whether cause exists on a case-by-case basis."); *In re RML Development, Inc.*, 528 B.R. 150, 155 (Bankr. W.D. Tenn. 2014) ("Because the Code provides no definition of what constitutes 'cause' . . . , courts must determine whether discretionary relief is appropriate on a case-by-case basis.") (internal citations omitted).

140. Numerous courts have found that a genuine dispute as to the validity of a creditor's underlying claim constitutes sufficient "cause" under Bankruptcy Code section 363(k) to abrogate or limit a creditor's right to credit bid. *See, e.g.*, *In re CS Mining, LLC,* 574 B.R. 259, 285 (Bankr. D. Utah 2017) (denying creditor's right to credit bid where its claim was subject to pending objection and adversary proceeding); *In re Fisker Automotive Holdings, Inc.*, 510 B.R. 55, 60 (Bankr. D. Del. 2014) (finding cause existed to cap credit bid at fraction of amount proposed by creditor due to dispute as to amount of creditor's secured claim); *RML*, 528 B.R. at 156 (prohibiting creditor from credit bidding portion of its claim that was subject to pending objection); *In re Daufuskie Island Props., LLC*, 441 B.R. 60, 64 (Bankr. D.S.C. 2010) (finding cause to deny credit bid due to dispute over validity of creditor's claim and lien as a result of pending adversary proceeding to avoid lien as preference and for equitable subordination of claim); *see also Aeropostale*, 555 B.R. at 415 (denying debtors' motion to bar creditor from bidding its claim but acknowledging that dispute over validity of a creditor's lien may constitute cause to limit credit bid).

141. Here, the ESL Claims (including the Credit Bid Claims) are subject to the pending ESL Claims Objection, Standing Motion and Proposed Complaint, pursuant to which the Creditors' Committee seeks to disallow, recharacterize and/or equitably subordinate such claims.

The Credit Bid Claims are squarely in dispute and, as such, cannot support a credit bid pursuant to section 363(k), regardless of the Debtors' efforts to contract around the requirements of the Bankruptcy Code. *See, e.g*, *In re CS Mining*, 574 B.R. at 285 (denying a settlement agreement that permitted credit bidding in part because the credit bid was impermissible under section 363(k) due to a pending dispute over the claims).

142. Until the ESL Claims Objection, Standing Motion and Proposed Complaint are heard and resolved, the Credit Bid Claims are not allowed claims and should not be credit bid. *See* 11 U.S.C. § 502(b) (requiring, if a claim objection is made, that "the court, ***after notice and a hearing***, ***shall*** determine the amount of such claim . . . and shall allow such claim . . .") (emphasis added). The estates' valuable causes of action include the following.

1. The 2016-2018 ESL Contributions Should Be Recharacterized as Equity

143. A debt recharacterization claim against ESL finds strong support in the facts. As set forth in detail in the Proposed Complaint, the Creditors' Committee's Investigation has identified numerous facts demonstrating that Lampert, ESL and the Debtors had a clear intent, expectation and understanding that the 2016-2018 ESL Contributions were capital contributions and not debt transactions. For the following reasons, that clear intent compels recharacterization of the 2016-2018 ESL Contributions as equity. *See In re Lyondell Chem. Co.*, 544 B.R. 75, 101 (Bankr. S.D.N.Y. 2016) (noting that when determining whether to recharacterize a purported debt investment as equity, the "overarching inquiry" is "to discern the intent of the parties").

144. ***First***, the 2016-2018 ESL Contributions were part of Lampert's and ESL's insider scheme to purchase Sears's remaining capital assets at a discount for Lampert's and ESL's own benefit, to the substantial detriment of Sears and its creditors. Lampert and ESL stood on both sides of each of the 2016-2018 ESL Contributions, exercising control both as lender and borrower (as Sears's CEO, Chairman of the Board and controlling shareholder). During the

period from 2016 to 2018, Sears's financial performance declined continually, and Sears became completely reliant upon ESL to fund its operations. In fact, receiving contributions from ESL was the Company's preferred method of funding because it was able to get the necessary money without dealing with third party financing sources. ESL's capital contributions to an entity it controlled were the classic, "paradigmatic" example of a recharacterization case. *See In re BH S&B Holdings LLC*, 420 B.R. 112, 157 (Bankr. S.D.N.Y. 2009) (observing that the "paradigmatic recharacterization case involves a situation where the same individuals or entities (or affiliates of such) control both the transferor and the transferee, and inferences can be drawn that funds were put into an enterprise with little or no expectation that they would be paid back along with other creditor claims") (internal quotations omitted).

145. Moreover, because the 2016-2018 ESL Contributions were not arm's-length transactions with third parties, they did not reflect financing terms that could have been obtained from outside lending institutions. Indeed, Sears sought capital from ESL because the terms it could offer were "not acceptable" to outside lenders. That no reasonable outside lender would offer to lend money to the Debtors on similar terms supports recharacterization. *See In re AutoStyle Plastics*, 238 B.R. 346, 350 (Bankr. W.D. Mich. 1999) (citing *In re Cold Harbor Assocs. L.P.*, 204 B.R. 904, 918 (Bankr. E.D. Va. 1997) (evidence that "a reasonable outside creditor would [not] have made a loan to the debtor on similar terms" weighs in favor of recharacterization)); s*ee also BH S&B Holdings*, 420 B.R. at 158 (explaining that this factor looks at whether "a reasonable creditor would have acted in the same manner") (citation omitted).

146. Meanwhile, Lampert and ESL—insiders with control over Sears—were fully aware of Sears's declining performance and these inevitable Chapter 11 Cases. ESL used

Sears's dependence on ESL to encumber Sears's most valuable remaining unencumbered assets. The 2016-2018 ESL Contributions amounted to an attempt by ESL to unfairly leverage its insider status to effectively purchase Sears's capital assets in anticipation of these Chapter 11 Cases and ultimately by use of a credit bid to purchase substantially all of the Debtors' assets. These facts demonstrate that the 2016-2018 ESL Contributions are "paradigmatic example[s]" of equity contributions by self-dealing insiders who did not intend to be repaid along with other creditors. *See BH S&B Holdings*, 420 B.R. at 157.

147. ***Second***, neither Sears nor ESL intended or expected that Sears would repay the 2016-2018 ESL Contributions on any schedule, a critical characteristic of a true debt transaction. When they entered into the 2016-2018 ESL Contributions, the Debtors were not adequately capitalized, being just a shadow of what they once were after Lampert and ESL robbed them of value through the years-long asset-stripping scheme. Sears never had any hope of repaying the purported debt. As explained in the Proposed Complaint, directors of Holdings and Lampert himself were aware of analyses that showed continuous year-over-year declines in Sears's operating metrics (on a consolidated basis). Likewise, the Board was aware of the continual need—beginning in at least 2016—for Sears to obtain funds from ESL to avoid an imminent chapter 11 filing, notwithstanding ever-declining cash flows. Such "[t]hin or inadequate capitalization is strong evidence that the advances are capital contributions rather than loans." *In re AutoStyle Plastics, Inc.*, 269 F.3d 726, 751 (6th Cir. 2001); *see also Lyondell*, 544 B.R. at 97 (inadequate capitalization factor satisfied where the plaintiff alleged that, at the time of the purported loans, the debtors "were overleveraged, had grossly insufficient liquidity, and were severely undercapitalized").

148. Lampert and ESL correspondingly knew that Sears could repay the 2016-2018 ESL Contributions only if Sears's performance improved dramatically. Lampert and ESL also knew, given their long-term relationship with and control over Sears, that there was no realistic expectation for such a turnaround. Lampert's and ESL's expectations and intent were that Sears could not repay the 2016-2018 ESL Contributions and that ESL would instead receive options on the collateral securing the 2016-2018 ESL Contributions that could be called upon through a credit bid. These facts further support recharacterization of the 2016-2018 ESL Contributions. *See AutoStyle*, 269 F.3d at 751 ("If the expectation of repayment depends solely on the success of the borrower's business, the transaction has the appearance of a capital contribution."). To prevail on a recharacterization claim, a plaintiff need not establish that repayment is "solely dependent on the success of borrower's business." *Lyondell*, 544 B.R. at 96. Indeed, so long as the parties expected that the source of repayment would be the debtor's future earnings, this factor is satisfied notwithstanding any security interest associated with the purported debt, including a lien on all of the debtor's assets. *See, e.g.*, *AutoStyle*, 269 F.3d at 751 (holding that because source of repayment of the purported loan was borrower's earnings, this factor weighed in favor of recharacterization, notwithstanding that the purported loan was secured by a lien on all of borrower's assets); *BH S&B Holdings*, 420 B.R. at 159 (finding source of repayment factor satisfied where complaint pled that repayment would be from the debtor's earnings despite lender's argument that, because loan was secured by all of debtor's assets, repayment was not contingent on success of the business); *Lyondell*, 544 B.R. at 96-97 (finding factor satisfied where plaintiff alleged that debtor was overleveraged and insolvent at time of loan, lenders were aware of liquidity issues and that assets were already pledged to secured creditors, and that lenders could not expect their unsecured claims to repaid except by means of future profit).

149. Moreover, the fraudulent financial projections that Lampert and ESL required Sears's management to adopt for Sears's Annual Plan underscore Lampert's and ESL's knowledge of Sears's inability to repay the 2016-2018 ESL Contributions absent a massive and implausible turnaround in the Company's performance.

150. ***Third***, ESL provided the 2016-2018 ESL Contributions to buy time to acquire Sears's other assets for Lampert's and ESL's own benefit. ESL never intended to be repaid on a schedule characteristic of debt but rather to improve its equity positions and control over Sears's capital assets. For example, prior to these Chapter 11 Cases, ESL indicated interest in purchasing for itself certain business lines of Sears Home Services, as well as the Kenmore brand.

151. ***Fourth***, ESL provided the 2016-2018 ESL Contributions to play out its options on Sears without any apparent downside. By infusing capital into Sears, ESL potentially stood to gain from a rising stock price at Sears. And if Sears continued to fail, ESL's investments were protected by collateral that would not be available to satisfy the claims of other creditors. Like the capital contributions of an investor who expects returns based only on the investment's fortunes (unlike on interest according to a regular schedule), these options bear the hallmarks of equity. *See In re SubMicron Sys. Corp.*, 432 F.3d 448, 455-56 (3d Cir. 2006) (noting that when "funds infused are repaid based on the borrower's fortunes . . . they are equity").

152. ***Fifth***, ESL provided the 2016-2018 ESL Contributions with the intent and purpose to protect its investments in non-Debtor entities that depended on Sears remaining, at least for a time, outside of bankruptcy—including Seritage. After the Seritage Transaction, Seritage and its former Sears properties had become a key part of ESL's portfolio. For years after Seritage's formation, however, it relied heavily on Sears for rental income to fund its

recapture and redevelopment of Sears stores for more profitable uses. Because the financial health of Sears was of such concern to Seritage, Lampert and ESL had Seritage spend significant time, money and effort monitoring Sears (including by hiring financial advisors) and keeping Sears out of bankruptcy proceedings.

153. On information and belief, ESL similarly intended for the 2016-2018 ESL Contributions to protect its equity positions in other non-Debtor investments that depended on Sears remaining outside of bankruptcy, including in Lands' End (which maintains numerous Lands' End Shops at Sears) and other business units that had been spun off for ESL's benefit.

154. Granted, the documentation of the 2016-2018 ESL Contributions ***looks*** like that of debt transactions, but that is only because Lampert and ESL put in significant effort to try to disguise their equity contributions. As the facts alleged above indicate, the specific circumstances underlying these Chapter 11 Cases—namely, Lampert's and ESL's years-long abuse of their insider positions at Sears to rob it and its legitimate creditors of value and maximize their own equity investments in Sears and Sears-related businesses—show that both ESL and Sears intended for and understood that the 2016-2018 ESL Contributions were, in truth, capital infusions into a company controlled by the lender. The 2016-2018 ESL Contributions never were debt and should be recharacterized as equity.

2. ESL's Claims are Subject to Equitable Subordination

155. The facts developed through the Creditors' Committee's Investigation are equally supportive of an equitable subordination claim. The purpose of equitable subordination is "to undo wrongdoing by an individual creditor in the interest of the other creditors." *In re AppliedTheory Corp.*, 345 B.R. 56, 59 (S.D.N.Y. 2006), *aff'd*, 493 F.3d 82 (2d Cir. 2007); 11 U.S.C. § 510(c)(1). Recognizing that insider transactions merit rigorous scrutiny, courts have held that the threshold for inequitable conduct of an insider is satisfied by "virtually any conduct

by which an insider gains an advantage over creditors." *In re Hoffman Assocs.*, 194 B.R. 943, 965 (Bankr. D.S.C. 1995).

156. The facts both above and in the Proposed Complaint paint a clear and factually supported picture of how Lampert and ESL abused insider status and positions of trust with Sears to strip away assets for their own benefit, to the substantial detriment of Sears and its stakeholders. Indeed, Lampert, as CEO and Chairman of the Board, and ESL, as controlling shareholder (with Lampert), breached fiduciary duties to Sears and engaged in a pattern of unfair conduct since the mid-2000s that unjustly enriched Lampert and ESL. This pattern of unfair conduct and breaches of fiduciary duties is characterized by, among other things:

- Lampert and ESL abusing their control over Sears to extract cash through unreasonable stock repurchases. From 2005 to 2008, Lampert and ESL caused Sears to spend over $6 billion—the majority of its cash—on stock repurchases in order to enrich themselves on fees earned from ESL's investors while Sears fell into disrepair as Lampert and ESL slashed corporate reinvestment by half.

- Lampert and ESL crafting unsupportable, downright fraudulent financial projections that bore no relation to reality and grossly misrepresented Sears's performance, underscoring their knowledge of, and efforts to hide, Sears's insolvency and inevitable bankruptcy. For 2010-2017, Sears missed the Lampert/ESL-set revenue target every year by an average of more than $4 billion per year (a 13 percent miss from projections), and missed the EBITDAP target every year by an average of nearly $1.4 billion per year (a 172 percent miss from projections).

- Requiring Sears's management to adopt Lampert's and ESL's manufactured projections to further their asset-stripping scheme, including by, among other things, requiring that management use those projections to produce false solvency reports and conceal Sears's actual performance. Specifically, the Seritage Transaction, the Lands' End spin-off and the 2016-2018 ESL Contributions were made possible by Lampert's and ESL's misleading projections (which were fed to advisors who based solvency and fairness opinions on them).

- Recognizing the declining prospects of the Sears enterprise, Lampert and ESL abusing their control over Sears to extract the most valuable assets of Sears through a series of asset spin-offs and rights offerings as Sears continued to decline toward bankruptcy in an attempt to shield the value of such assets from Sears's creditors.

- Through the Seritage Transaction, Lampert and ESL orchestrating transfers of some of Sears's most valuable real estate assets to new and separate entities over which ESL (and Lampert) retained significant ownership and control, all in order to shield such assets from the claims of Sears's other creditors.

- Lampert and ESL engaging in inequitable conduct by taking advantage of insider control on both sides of the Seritage Transaction in order to achieve a result that could not be negotiated at arm's-length. In particular, after completion of the Seritage Transaction, Lampert and ESL directly benefited by (i) receiving at least $76 million in dividends as a Seritage shareholder, (ii) enjoying an equity stake in Seritage that had grown within one year to be worth approximately $1.25 billion (compared to the $750 million ESL originally paid for such stake), and (iii) exiting nearly at par from $165 million of second lien notes, even when doing so clearly was contrary to Sears's best interests and ongoing need for liquidity.

- ESL intentionally keeping Sears out of bankruptcy through a series of improper financing transactions, including the 2016-2018 ESL Contributions, and its extensive use of commercial paper, in order to mask Sears's insolvency and delay its inevitable demise; buy time to siphon off Sears's cash flows; and cordon off valuable assets, including real estate, as collateral for Lampert's and ESL's benefit; hinder, delay, or defraud other creditors' recoveries; and preserve the value of Seritage until it could wean itself off of Sears for the benefit of ESL—Seritage's controlling shareholder.

157. Further, Lampert and ESL used and controlled the Debtors as an alter ego for their own benefit. For example, the Proposed Complaint details that:

- Lampert and ESL caused Sears to form Seritage and enter into the Seritage Transaction to maximize ESL's investment in Seritage, despite the blatant unfairness of the Seritage Transaction to Sears and its creditors. Lampert used Sears as an alter ego to enter into this insider, below-market transaction for ESL's benefit.

- Lampert and ESL caused Sears to enter into secured "loan" transactions with ESL, including the 2016-2018 ESL Contributions, at a time when Sears was insolvent in order to prop up Sears, lien up its remaining prized assets, and provide the greatest returns on ESL's investments.

158. While equitable subordination sometimes is described as an "extraordinary remedy," this is an extraordinary case where equitable subordination is necessary to achieve justice. Lampert and ESL's conduct leading to Sears's downfall is grossly inequitable and certainly justifies equitable subordination. Courts have found inequitable conduct sufficient to

justify equitably subordinating claims under similar (even less egregious) facts. *See, e.g.*, *N.J. Steel Corp. v. Bank of N.Y.*, No. 95 CIV 3071 (KMW), 1997 WL 716911, at *5 (S.D.N.Y. Nov. 17, 1997) (holding that allegations that, *inter alia*, a creditor and insider of the debtor conducted a dubious lease-back deal with the debtor constituted inequitable conduct sufficient to state a claim for equitable subordination); *In re Winstar Commc'ns, Inc.*, 554 F.3d 382, 412-13 (3d Cir. 2009) (equitably subordinating claims of an insider creditor who propped-up debtor to inflate its own revenue stream and caused the debtor to purchase hundreds of millions of dollars of unneeded equipment from creditor); *Fabricators, Inc. v. Technical Fabricators, Inc. (In re Fabricators, Inc.)*, 926 F.2d 1458, 1468 (5th Cir. 1991) (affirming bankruptcy court's decision to equitably subordinate insider creditor's claims where obtaining liens on debtor's assets was not an isolated act, but rather "one step interconnected with a series of actions . . . to gain an advantage over the position of other creditors"); *Goode v. Hagerty (In re Sys. Impact, Inc.)*, 229 B.R. 363 (Bankr. E.D. Va. 1998) (equitably subordinating claims of individual directors to those of debtor's other creditors where directors had elevated the status of their own claims above those of non-insider creditors,); *Official Comm. of Unsecured Creditors v. Credit Suisse First Boston (In re Exide Techs., Inc.)*, 299 B.R. 732, 744-46 (Bankr. D. Del. 2003) (denying motion to dismiss claim for equitable subordination based on allegations that insider used its position and leverage to obtain collateral and security from debtor when debtor's economic position was deteriorating rapidly); *Hoffman Assocs.*, 194 B.R. at 963-65 (equitably subordinating creditor's claims whose owner, in his role as the sole director of the debtor, caused the debtor to grant the creditor liens on substantially all of the debtor's assets and paid the debtor's expenses with loans from the creditor). Since taking control of Sears in 2005, Lampert and ESL have leveraged their insider status to give their claims an unfair advantage over those of other creditors. They

successfully stripped Sears of some of its most valuable assets, and then fully aware that bankruptcy proceedings were inevitable, acted to wall off other creditors from the remaining valuable assets of Sears. In short, the facts demonstrate a clear pattern of inequitable conduct by ESL that requires equitable subordination of its purported debt to the claims of the unsecured creditors.

3. ESL's Claims Are Subject to Disallowance Under Bankruptcy Code Section 502(d)

159. Because ESL is the transferee or beneficiary of avoidable fraudulent transfers—namely, the Seritage Transaction, the Lands' End spin-off, and the 2016-2018 ESL Contributions—all of its claims against the Debtors' estates must be disallowed unless and until ESL returns the property or the value of the property it received from such transfers.

160. Bankruptcy Code section 502(d) provides that a court ***shall*** disallow "any claim of any entity . . . that is a transferee" of an avoidable transfer "under section[s] 522(f), 522(h), 544, 545, 547, 548, 549 or 724(a) . . . unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section . . . 550 . . . of this title." 11 U.S.C. § 502(d).[49] "The legislative history and policy behind Section 502(d) illustrates that the section is intended to have the coercive effect of insuring compliance with judicial orders." *Campbell v. United States (In re Davis)*, 889 F.2d 658, 661 (5th Cir. 1989). Indeed, as this Court has held, section 502(d) requires the court to disallow ***any and all*** claims of a liable entity, including transfer beneficiaries, irrespective of whether those claims arise from the avoidable transaction. *Geltzer v. Mooney, et al. (In re MacMenamin's Grill Ltd.)*, 450 B.R. 414, 429 (Bankr. S.D.N.Y. 2011) (Drain, J.) (observing that section 502(d) "provides for the

[49] Through its reference to entities found liable under Bankruptcy Code section 550, section 502(d) applies not only to initial transferees of avoidable property, but also to subsequent transferees of such property and "entities for whose benefit a transfer was made." 11 U.S.C. § 550(a).

disallowance of 'any claim' of an entity from which property is recoverable under section 550 or that is a transferee of an avoidable transfer, regardless whether the claim is related to the transfer"). Moreover, this Court has also recognized that section 502(d) "does not even necessarily require the entry of a judgment, let alone the failure to enforce one, for a claim to be disallowed." *In re Red Dot Scenic, Inc.*, 313 B.R. 181, 186 (Bankr. S.D.N.Y. 2004) (Drain, J.).

161. Here, the facts ***overwhelmingly*** support causes of action against ESL that justify disallowance of the ESL Claims pursuant to Bankruptcy Code section 502(d).

162. ***First***, the Seritage Transaction is voidable both as an actual and a constructive fraudulent transfer under Bankruptcy Code section 544 and applicable state law, and the value of the properties transferred in the Seritage Transaction is recoverable from Lampert and ESL as entities for whose benefit the transfer was made under Bankruptcy Code section 550.

163. The facts show that Sears, under the control of Lampert and ESL—who exercised undue influence over and controlled Sears in their roles as insiders—did not act in good faith in connection with the Seritage Transaction and, instead, acted with actual intent to hinder, delay or defraud creditors. Specifically, the following facts constitute "badges of fraud" sufficient to find actual intent to support an actual fraudulent transfer claim with respect to Seritage:

- Sears did not receive reasonably equivalent value for the properties transferred. The valuation methodology utilized by Cushman & Wakefield was transparently flawed in several ways, including that it assumed Sears would remain a permanent tenant paying a discounted rate indefinitely even though the premise of the transaction was that Seritage would recapture space and release it at higher rents, and thus was specifically designed to lead to artificially low property appraisals. These below-market property appraisals dictated the $2.7 billion consideration paid to Sears in connection with the Seritage Transaction, thereby resulting in Sears receiving less than reasonably equivalent value for the transferred assets. The market's reaction to the Seritage Transaction—both before it was closed via high trading prices of rights to purchase class A common stock as well as after it closed—also demonstrate the lack of reasonably equivalent value received by Sears.

- Lampert and ESL knew or reasonably should have known that Sears did not receive reasonably equivalent value, especially given their knowledge of the trading prices of the rights to purchase class A common shares of Seritage implying significantly higher valuation by the market than reflected in the $2.7 billion purchase price. In fact, Sears's CFO specifically observed in an email to top management just weeks before the Seritage Transaction closed that "the market thinks [Sears] is selling something for about $600M less than it is worth."

- There was no marketing process or efforts to determine what a third-party would pay for the assets in an arm's-length transaction.

- Sears was insolvent at the time of the Seritage Transaction—a fact that Lampert and ESL knew or reasonably should have known.

- The Seritage Transaction was a questionable transfer not made in the usual course of business. Sears's own advisors described the terms of the Seritage Transaction and resulting Master Leases as "unique" and "unusual" in how such terms favored Seritage's right to recapture and redevelop properties.

- Lampert and ESL stood on both sides of the Seritage Transaction as insiders of both Sears and Seritage with close relationships with, and unchecked control of, both Sears (through Lampert as its controlling shareholder, Chairman of the Board, and CEO) and Seritage (through Lampert as its Chairman of the Board of trustees and controlling shareholder). The Board and the RPT Subcommittee did not serve as adequate checks on Lampert's and ESL's self-dealing, and simply rubber-stamped the Seritage Transaction.

- Sears's financial condition both before and after the Seritage Transaction—that of hopeless insolvency, as demonstrated by proper discounted cash flow analysis, comparable companies analysis and liquidation analysis—underscores Lampert's and ESL's intent to take real estate assets from Sears and attempt to shield their value from Sears's real creditors in inevitable bankruptcy proceedings.

- The Seritage Transaction is part of a cumulative effect of a pattern or series of transactions after the incurrence of debt and onset of financial difficulties at Sears that includes other Lampert/ESL-driven asset spin-offs (including the Lands' End and other spin-offs) and financing transactions (including the 2016-2018 ESL Contributions), all of which inured to Lampert's and ESL's direct benefit.

- The general chronology of the Seritage Transaction in the context of Sears's insolvency and inevitable bankruptcy proceedings indicates Lampert and ESL exercising undue influence over and control of Sears in their roles as insiders with an actual intent to hinder, delay or defraud creditors.

- The haste and unusualness of the Seritage Transaction, including the flawed methods by which the properties were appraised, the RPT Subcommittee's failure to hire independent appraisers, the unreasonable reliance by the advisors on

Lampert's and ESL's fraudulent projections and the lack of third-party marketing, also evidence Lampert's and ESL's actual intent to hinder, delay or defraud creditors.

164. These same facts show that the Seritage Transaction also is voidable as a constructive fraudulent transfer because the Debtors did not receive reasonably equivalent value in the Seritage Transaction and that the Debtors were insolvent at the time of the Seritage Transaction.

165. ***Second***, the Lands' End spin-off is voidable as an actual and constructive fraudulent transfer under Bankruptcy Code section 544 and applicable state law, and the value of the property transferred in the Lands' End spin-off is recoverable from Lampert and ESL as entities for whose benefit the transfer was made under Bankruptcy Code section 550 under section 550 of the Bankruptcy Code

166. The facts show that the Lands' End spin-off was engineered by Lampert and ESL, who exercised undue influence over and controlled Sears in their roles as insiders, did not act in good faith, and had an actual intent to hinder, delay or defraud the Debtors' creditors. Specifically, the following facts constitute "badges of fraud" sufficient to find actual intent:

- Sears did not receive reasonably equivalent value for the assets transferred through the Lands' End spin-off. Available indicia show that the $500 million cash dividend paid to Sears in connection with the Lands' End spin-off was between $900 million and $1 billion below reasonably equivalent value. Moreover, Sears had received an indication of interest from a third party to acquire Lands' End that used an enterprise valuation of $1.6 billion to $1.8 billion only months before the Lands' End spin-off was completed—also indicating that the dividend was between $1.1 billion and $1.3 billion shy of reasonably equivalent value to Sears.

- Sears was insolvent at the time of the Lands' End spin-off—a fact that Lampert and ESL knew or should have known. Among other indicia, proper analysis based on reasonable projections informed by Sears's actual historical performance over the five years prior to the Lands' End spin-off show that the spin-off rendered Sears insolvent due to inadequate capital and failure to pay debts when they came due (if it was not already insolvent before).

- The Lands' End spin-off was a questionable transfer not made in the usual course of business. Sears's own Board considered the many negative implications of the Lands' End spin-off on Sears and were aware that Lands' End was one of the few profitable segments of Sears and its removal from the Sears enterprise would have a negative effect on Sears and its creditors.

- Lampert and ESL stood on both sides of the Lands' End spin-off and again, the Board did not serve as an adequate check on Lampert's and ESL's self-dealing, and simply rubber-stamped the Lands' End spin-off.

- Sears's financial condition both before and after the Lands' End spin-off—that of insolvency, years of consistently operating at a loss, and consistently negative EBITDAP following the Lands' End spin-off—underscores Lampert's and ESL's intent to strip the valuable Lands' End business from Sears and attempt to shield its value from Sears's real creditors in inevitable bankruptcy proceedings.

- Like Seritage, the Lands' End spin-off is part of a cumulative effect of a pattern or series of transactions after the incurrence of debt and onset of financial difficulties at Sears that includes other Lampert/ESL-driven asset spin-offs, the Seritage Transaction, and financing transactions (including the 2016-2018 ESL Contributions), all of which inured to Lampert's and ESL's direct benefit.

- The general chronology of the Lands' End spin-off in the context of Sears's insolvency and inevitable bankruptcy proceedings indicates Lampert and ESL exercising undue influence over and control of Sears in their roles as insiders with an actual intent to hinder, delay or defraud creditors.

- The haste and unusualness of the Lands' End spin-off, including the flawed methods by which the properties were appraised, the unreasonable reliance by advisors on Lampert's and ESL's fraudulent projections, and the lack of third-party marketing, also evidence Lampert's and ESL's intent to hinder, delay or defraud creditors.

167. Likewise, these same facts show that the Lands' End spin-off is voidable as a constructive fraudulent transfer because the Debtors did not receive reasonably equivalent value and they were rendered insolvent by the spin-off (if not already insolvent at the time).

168. ***Third***, each of the 2016-2018 ESL Contributions is voidable as an actual fraudulent transfer and the IP/Ground Lease Term Loan Facility also is voidable as a constructive fraudulent transfer under Bankruptcy Code sections 544 and 548 and applicable state law, and the value of the property transferred in the 2016-2018 ESL Contributions is

recoverable from Lampert and ESL as entities for whose benefit such transfers were made under Bankruptcy Code section 550.

169. As demonstrated above and in the Proposed Complaint, the facts show that each of the 2016-2018 ESL Contributions was made or directed by Lampert and/or ESL, who exercised undue influence over and control of Sears in their roles as insiders, causing the Debtors to enter into each of the 2016-2018 ESL Contributions with an actual intent to hinder, delay, or defraud creditors.

170. Lampert and/or ESL's actual intent to hinder, delay, or defraud creditors is demonstrated by, among other things, the following facts and "badges of fraud":

- Each of the 2016-2018 ESL Contributions was an insider transaction. Lampert and ESL stood on both sides of each financing transaction—on the one side as a lender and on the other as a controlling shareholder. Through Lampert's role as Chairman of the Board and as Sears's CEO, he was able to exercise a high degree of control over the Company. As usual, the Board and the RPT Subcommittee failed to serve as effective controls on Lampert and ESL's self-dealing, and again rubber-stamped each subject transaction.

- Each of the 2016-2018 ESL Contributions was made at a time when Sears was insolvent—a fact that Lampert and ESL knew or should have known.

- Reasonably equivalent value was not given to each of Sears Brands Business Unit Corporation, Sears Brands, L.L.C., Sears Development Co. and STI Merchandising, Inc. (the "Additional Subsidiaries") for the grants, pledges or guarantees they made in connection with certain of the 2016-2018 ESL Contributions, including the IP/Ground Lease Term Loan Facility.

- Sears's financial condition both before and after each of the 2016-2018 ESL Contributions—that of hopeless insolvency—underscores Lampert's and ESL's intent to encumber valuable remaining unencumbered assets and attempt to deprive other creditors of recoveries in these inevitable bankruptcy cases.

- Lampert and ESL crafted unsupportable and downright fraudulent financial projections that bore no relation to reality and grossly misrepresented Sears's performance, which underscored Lampert's and ESL's knowledge of—and efforts to disguise—Sears's insolvency and inevitable bankruptcy.

- Lampert and ESL required management to adopt their manufactured projections to further their scheme, including by, among other things, requiring that Sears's

management use those projections to produce false solvency reports and conceal Sears's actual performance to support the 2016-2018 ESL Contributions.

- Each of the 2016-2018 ESL Contributions is part of a cumulative effect of a pattern or series of transactions after the incurrence of debt and onset of financial difficulties at Sears that hastened its demise. This pattern or series includes other Lampert/ESL-driven asset spin-offs (including the Lands' End and others) and the Seritage Transaction, all of which inured to Lampert's and ESL's direct benefit.

- The general chronology of the 2016-2018 ESL Contributions in the context of Sears's years-long insolvency and inevitable bankruptcy proceedings is evidence of Lampert and ESL exercising undue influence over and control of Sears in their roles as insiders with an actual intent to hinder, delay or defraud creditors.

- The haste and unusualness of each of the 2016-2018 ESL Contributions also point to Lampert's and ESL's actual intent to hinder, delay or defraud creditors. For instance, each of the ESL deals was closed hastily and without the same standards of due diligence when compared to third party financings.[50] Additionally, the RPT Subcommittee did not adequately vet the financings provided by ESL. Nor were the financings market-tested in any real way.[51]

171. Additionally, guarantees and asset grants in connection with IP/Ground Lease Term Loan Facility are voidable as constructive fraudulent transfers because none of the Additional Subsidiaries received any benefit or value in exchange for committing collateral and incurring obligations under the IP/Ground Lease Term Loan Facility. Moreover, each of these Debtor entities was insolvent at the time the IP/Ground Lease Term Loan was created or was rendered insolvent thereby.

172. Because Lampert and ESL were entities for whose benefit each of the foregoing transfers were made and neither has returned to the Debtors' estates the property transferred (or

[50] Schriesheim noted in his interview that ESL closed deals on "a more expeditious basis" compared to third parties, and that there were "certain documents that [ESL] wouldn't require or [Lampert] was fine with if they were followed up subsequent to closing, like environmental" even though such documents were typically "a big deal" in real estate transactions.

[51] A representative from the RPT Subcommittee's financial advisor, Centerview, stated in his interview that "we did this on a fairly accelerated timeframe. Typically, it was under some pressure, covenant pressure or liquidity pressure" and that "we knew with ESL . . . we always needed to work very quickly." As an example, he stated that the RPT Subcommittee would "just call up Centerview on a Monday and by the following Friday, had to advise the company as to their views on a transaction."

the value of the property transferred) in the Seritage Transaction, the Lands' End spin-off, or the 2016-2018 ESL Contributions (including the IP/Ground Lease Term Loan Facility), any and all claims of ESL, and/or its assignees, against the Debtors' estates must be disallowed under section 502(d) of the Bankruptcy Code until such time as Lampert or ESL returns to the Debtors' estates the value of the property transferred in those transactions.

173. Given the genuine and significant disputes concerning the allowance of the ESL Claims, ESL should not be permitted to credit bid under Bankruptcy Code section 363(k).

B. If ESL Is Permitted to Credit Bid, Protections Must Be Put in Place

174. For the reasons articulated herein, to the extent the Court allows ESL to credit bid ***any*** of its claims, protections must be put in place to ensure that such credit bid comports with applicable law and the orders of this Court. Specifically: (i) ESL should be required to backstop any credit bid in respect of disputed claims, as previously directed by this Court; (ii) any ESL credit bid should serve to limit the amount of the ESL Claims that are deemed "allowed" pursuant to the terms of the APA; and (iii) ESL should be required to confirm the value of the collateral securing the Credit Bid Claims and provide an allocation of such claims to the specific assets that secure such claims (and therefore can be acquired pursuant to the credit bid), as required by the Global Bidding Procedures. Absent such protections, the Creditors' Committee respectfully submits that ESL's proposed credit bid must be denied in its entirety.

1. ESL Should Be Required to Backstop any Credit Bid

175. As discussed *supra* and set forth in the Standing Motion, Proposed Complaint and ESL Claims Objection, there is substantial doubt regarding the validity of the ESL Claims and ESL's potential liability to the estates. Accordingly, if ESL is permitted to credit bid the Credit Bid Claims, the only measure that would provide sufficient protection to the estates that a proper remedy will be available following successful prosecution of the causes of action discussed

herein is an order requiring ESL to backstop its credit bid with cash or an irrevocable letter of credit from a third party bank in the full amount of the credit bid. Such security could be held in escrow pending complete resolution of the ESL Claims Objection and the Standing Motion (and any potential adversary proceeding arising therefrom). If ESL is correct that its hands are clean, it will receive its security back. If the Creditors' Committee is correct, the estates will have a remedy for Lampert's and ESL's wrongful conduct.

176. The imposition of this provisional remedy is not new to ESL. Indeed, this Court advised ESL previously that if it wanted to credit bid despite the existence of colorable claims against it, ESL may be required to provide security to the estates. *See* Dec. 18 Hr'g. Tr. 21:2-11 ("I mean, I don't want to be cryptic, I mean you want to finesse it is to say [*sic*] that if it turns out later that the claim can't be bid then you back it up with cash, but absent a modification of the bid, this is what needs to be undertaken."); Nov. 15 Hr'g. Tr. 59:21-60:4 ("And you well know that I have more than—many times held that, if there's some legitimate issue, either about what the collateral is that's in the package that's being bid on, or about the claim or the lien, ***I require people who want to credit bid to show that they have the cash to back it up, if it turns out that's a real issue***.") (emphasis added).

177. Other courts have exercised their equitable powers to place similar conditions on the exercise of a credit bid under similar circumstances. *See, e.g.*, *RML*, 528 B.R. at 157 (requiring creditor to submit letter of credit, surety bond or other similar instrument in order to proceed with credit bid in light of dispute over validity of creditor's claims); *In re Octagon Roofing*, 123 B.R. 583, 592 (Bankr. N.D. Ill. 1991) (noting that court had previously ordered creditor to post an irrevocable letter of credit from a third party bank in order to proceed with

credit bid in light of chapter 7 trustee's adversary proceeding to avoid lien and claim of creditor as fraudulent conveyance or preference). The circumstances here warrant such vital protection.

2. If ESL Is Permitted To Credit Bid, ESL's Claims Should Not Be Allowed in Excess of the Amount Permitted To Be Credit Bid

178. The Creditors' Committee respectfully submits that there is ample evidence in the record that the causes of action that underlie the Proposed Complaint and the objections to the ESL Claims set forth in the ESL Claims Objection are colorable and highly valuable to the Debtors' estates and the proposed Release Consideration is woefully inadequate. In the event this Court nevertheless is inclined to permit ESL to credit bid any portion of the Credit Bid Claims, in addition to the other remedies requested herein (such as the provision of cash or a letter of credit to backstop such credit bid), the Creditors' Committee submits that the Court should preserve the Creditors' Committee's ability to dispute the allowance of any of the ESL Claims not used for purposes of the credit bid.

179. Bankruptcy courts "have broad equitable powers and the ability to invoke equitable principles to achieve fairness and justice in the reorganization process." *LightSquared LP v. SP Special Opportunities LLC (In re LightSquared Inc.)*, 511 B.R. 253, 346 (Bankr. S.D.N.Y. 2014). To that end, pursuant to Bankruptcy Code section 510(c)(1), a bankruptcy court may, "under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim." 11 U.S.C. § 510(c); *see also In re Aeropostale, Inc.*, 555 B.R. at 397 (noting same and quoting 11 U.S.C. § 510(c)(1)); *Picard v. Merkin (In re Bernard L. Madoff Inv. Secs. LLC)*, 515 B.R. 117, 157-58 (Bankr. S.D.N.Y. 2014) (same).

180. In order for the ESL Sale to be consummated, there is no need for the ESL Claims in excess of the Credit Bid Claims to be deemed allowed, as provided in the APA. *See* APA

§ 9.13 and Ex. G; Proposed Sale Order ¶ 7(b). Indeed, as the Credit Bid Claims are over 50 percent of the ESL Claims, preserving the Creditors' Committee's ability to challenge the allowance of the remainder of the ESL Claims would permit the Debtors' estates to have recourse, albeit a fraction of the full amount of recourse, for Lampert's and ESL's destructive and self-serving conduct that has imperiled these estates. As the focus of ESL wanting its claims allowed always has been for purposes of credit bidding, it should not be permitted to bootstrap allowance of all of its claims for all purposes in connection with the ESL Sale, particularly not without the Creditors' Committee having had the opportunity to prosecute its Standing Motion and the ESL Claims Objection.

3. If Permitted To Credit Bid, ESL Must Allocate Its Credit Bid to the Collateral Securing the Underlying Debt

181. It is indisputable that a secured creditor only is entitled to credit bid its secured claims in respect of the collateral that secures such claims and, then, only to the extent of the creditors' interests in the estate's interests in such collateral. *RadLAX Gateway Hotel v. Amalgamated Bank*, 132 S.Ct. 2065, 2070 fn. 2 (2012) ("[Credit bidding] enables the creditor to purchase the collateral for what it considers the fair market price (up to the amount of its security interest)"); *In re Aeropostale, Inc.*, 555 B.R. at 414 (stating that a credit bid allows a secured creditor to bid for its collateral) (emphasis added); *In re Free Lance-Star Publishing Co.*, 512 B.R. 798, 805-06 (Bankr. E.D. Va. 2014) (ordering that a credit bid must be limited solely to those properties in which the secured creditor had a valid and properly perfected lien when creditor sought to credit bid unencumbered assets).

182. As such, if any credit bid is permitted here (which it should not be), then it must be attendant with certain protections, including (i) confirming the value of the collateral securing the claims to be credit bid and (ii) providing an allocation of the credit bid to the specific assets

that secures the Credit Bid Claims. Specifically, prior to being granted the right to credit bid the Credit Bid Claims, ESL should be required to demonstrate that the collateral securing such claims actually is worth the value thereof (*i.e.*, $1.33 billion) or, in the alternative, pay the estates, for the benefit of their unsecured creditors, the difference between the value that would be obtained on such claims in connection with a GOB process and the "value" being ascribed to such claims under the APA.

183. In addition, the credit bid portion of the purchase price and the assets acquired in connection therewith must be limited to the collateral securing such claims in accordance with applicable law. Because the collateral securing the Credit Bid Claims comprises specific assets and not a blanket lien on all assets, there must be an asset-by-asset breakdown of what ESL is acquiring under the credit bid portion of the purchase price. Notwithstanding the express provisions in the Global Bidding Procedures requiring a bidder to allocate its purchase price on an asset-by-asset basis, *see* Global Bidding Procedures § VI.D(3)(b), the ESL Bid does not provide for such allocation and [redacted]

184. Set forth below is the Creditors' Committee's analysis of the ESL Bid and an attempt to allocate the purchase price (including the credit bid portion thereof) based on, among other things, the terms of the APA, the Credit Bid Claims, the collateral purportedly securing the Credit Bid Claims, the terms of the Final DIP Order and applicable law. As set forth below, ESL effectively is not paying any consideration for a significant portion of the unencumbered assets it intends to acquire, including unencumbered real estate and Sears's valuable unencumbered

business units, including, among other things, PartsDirect, Innovel, Monark, Sears Home Services (repair business), Sears Auto Center and SHIP. *See* Jan. 15 Auction Tr. 67:10-16 (P. Basta) ("The analysis of the subcommittee and its financial advisors is that while ESL is, in fact, assuming liabilities, ***the unencumbered assets that they are receiving in exchange have a value that is greater than the liabilities that ESL is assuming***.") (emphasis added).

ESL "Consideration" vs. Assets Taken

[redacted]

185. The foregoing chart makes clear that ESL is not paying for a substantial portion of the assets that it is seeking to acquire in connection with the ESL Sale. As evidenced by the analyses prepared by the Debtors and the Creditors' Committee, the value of the assets for which ESL is offering ***no consideration*** (including unencumbered assets and equity value in real estate for which ESL is credit bidding) range from approximately [redacted], on the low end, to [redacted], on the high-end. Specifically, unencumbered real estate ranges in value from

[redacted] and, in the aggregate, the encumbered real estate has value of [redacted]. Credit card tort litigation ranges from [redacted]. Other encumbered assets, including numerous of the Debtors valuable business lines, range from [redacted] to [redacted]. By contrast, the consideration ESL offers in connection with its bid ranges from [redacted], on the low end, to [redacted], on the high end. The high end of this range assumes the payment of cure costs, as contemplated by the APA, but which payments would not be made in a wind-down scenario. Accordingly, there is a shortfall in ESL's purchase price in respect of [redacted], without even accounting for the paltry consideration of $35 million offered in respect of the Release. Clearly, ESL cannot acquire assets without paying for them. And since the ESL Sale does not provide any purchase price for such assets, the ESL Sale cannot be approved.

C. The Consideration for the Proposed Release Is Woefully Inadequate

186. Since the start of these Chapter 11 Cases, ESL has embarked on a public relations campaign to repaint itself as a savior of Sears, while simultaneously pursuing a broad release from liability for its years of wrongdoing against the Debtors and their stakeholders. With the first ESL Indicative Bid on December 5, 2018, ESL demanded a "full release . . . from any liability related to any prepetition transactions involving ESL." Each of its bids thereafter sought a similarly broad release, always offering minimal consideration in return.

187. During the Auction, the release transformed from being a "full" release to one that allowed all of the ESL Claims for practically all purposes in connection with the Chapter 11 Cases[52] and permitted ESL to credit bid the Credit Bid Claims freely as part of the ESL Sale. Specifically, the APA contemplates a release of ESL (which includes ESL Investments, Lampert,

[52] *See supra* Background, Part III.B.

certain affiliates, and any of their respective directors, officers, or employees in any capacity) from the "Released Estate Claims"[53] against ESL, which releases any estate causes of action against ESL that would limit ESL's right to credit bid or challenge or collaterally attack the allowance of the ESL Claims on any basis. At the same time, the Release purports to exclude from its reach any claims or causes of action for fraudulent transfer and breach of fiduciary duty or any claims or causes of action that are related to the Lands' End spin-off or the Seritage Transaction, but it does not achieve that result as the Release precludes remedies under Bankruptcy Code section 502(d) in connection with such transactions.

188. Specifically, by precluding challenges such as recharacterization, equitable subordination or any other challenge to the allowance of the ESL Claims, the Release waives the Debtors' rights under section 502(d) to seek to disallow the ESL Claims in connection with actual and constructive fraudulent transfers, including as related to Lands' End and Seritage. *See* 11 U.S.C. § 502(d). If these causes of action and related remedies were preserved, substantial

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[53] The APA defines "Released Estate Claims" to include:

> any and all Claims and causes of action of the Debtors and their estates against ESL arising under (i) sections 363(k), 502(a) or 510(c) of the Bankruptcy Code, (ii) equitable principles of subordination or recharacterization, or (iii) any other applicable Law that could be asserted to challenge the allowance of the ESL Claims pursuant to section 9.13(c). For the avoidance of doubt the Released Estate Claims do not include any other Claims or causes of action of the Debtors or their estates against ESL or any other Person, including but not limited to any Claims or causes of action (i) for constructive or actual fraudulent transfer under 11 U.S.C. 544(b) or 550(a) or any applicable state or federal law, for breach of fiduciary duty (including any Claims for breach of fiduciary duty in connection with the incurrence of any debt described on Exhibit G), or for illegal dividend under 8 Del. C. 170-174 or any other state law; (ii) that are related to Lands' End, Inc., the "spin-off" (as such term is defined in the Information Statement of Lands' End, Inc. dated March 18, 2014), Seritage Growth Properties, Inc., Seritage Growth Properties, L.P., or the "Transaction" (as that term is defined in the registration statement on Form S-11 filed by Seritage Growth Properties, which registration statement became effective on June 9, 2015), or (iii) that have been asserted by or on behalf of any party in interest in the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 cases captioned In the Matter of a Plan of Compromise or Arrangement of Sears Canada Inc., 9370-2751 Quebec Inc., 191020 Canada Inc., The Cut Inc., Sears Contact Services Inc., Initium Logistics Services Inc., Initium Commerce Labs Inc., Initium Trading and Sourcing Corp., Sears Floor Covering Centers Inc., 173470 Canada Inc., 2497089 Ontario Inc., 6988741 Canada Inc., 10011711 Canada Inc., 1592580 Ontario Limited, 955041 Alberta Ltd., 4201531 Canada Inc., 168886 Canada Inc., and 3339611 Canada Inc., Ontario Superior Court of Justice Court File No.:. CV-17-11846-00CL.

APA § 9.13(e).

value in the Debtors' estates could become unencumbered for the Debtors' unsecured and true third-party creditors. Under the current construct, however, the Debtors' only remedy in respect of these "preserved" causes of action is to seek damages against ESL, whose primary investment is anchored to a sinking ship. But the ESL Sale and Release would operate to eliminate the estates' ability to recover on any judgment from the Acquired Assets—assets or the value thereof that would be available in connection with a wind-down. In other words, the Debtors are permitting ESL to make immediate use of purported claims, through a credit bid, that would otherwise be the source of a remedy in an action against ESL (even if for a cause of action that is not directly included in the Released Estate Claims).

189. The facts surrounding ESL's and Lampert's prepetition conduct and scheming are astounding and provide ample support for causes of action for recharacterization, equitable subordination and disallowance against ESL. Such claims, if fully litigated, would eliminate the ESL Claims against these estates (in whole or in part), and ESL's ability to credit bid its purported secured claims, while returning immense value to the estates such that the $35 million Release Consideration cannot possibly be considered the exercise of sound business judgment, much less survive the stricter scrutiny applicable to insider transactions.

190. As discussed *supra*, in seeking approval for an insider transaction that is subject to heightened scrutiny under Bankruptcy Code section 363, the Debtors must demonstrate that they have received a "fair price." *See, e.g.*, *In re Flour City Bagels, LLC*, 557 B.R. at 79 (finding that debtor had not met burden of proof with respect to value of releases of claims against insider being given as part of insider's purchase of substantially all assets of the debtor); *In re Family Christian, LLC*, 533 B.R. at 628 (finding that debtors had not satisfied burden of establishing fairness of price for claims against insiders being released as part of insider's purchase of

substantially all of the assets of the debtors and stating that court would have difficulty approving transaction "without more significant disclosure and justification for the releases being granted by the Debtors"); *see also In re Lionel*, 722 F.2d at 1071 (noting that a court must evaluate "the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property").

191. The $35 million Release Consideration (plus the illusory and zero-value "other good and valuable consideration") represents nothing more than a nuisance payment for ESL to have the right to credit bid its secured claims in the nominal amount of $1.3 billion and allow the remainder of its claims (which likewise are subject to recharacterization, equitable subordination and disallowance under section 502(d)) for all purposes in connection with these Chapter 11 Cases. The Creditors' Committee seeks standing to recharacterize, equitably subordinate or disallow over $2 billion in ESL's claims against the Debtors. The chart below sets forth potential recoveries to general unsecured creditors on the estates' recharacterization, subordination.

[redacted]

See Burian Decl., Ex. B, at 18.

192. It is clear, therefore, that the contemplated Release is fundamentally at odds with a core tenet of the Bankruptcy Code: to maximize the value of the estates, including by prosecuting estate causes of action. *See CFTC v. Weintraub*, 471 U.S. 343, 352 (1985) (noting that the trustee of a bankruptcy estate has the duty to maximize the value of the estate, including by prosecuting claims against "officers, directors, and other insiders"); *Smart World Techs., LLC v. Juno Online Servs., Inc. (In re Smart World Techs., LLC)*, 423 F.3d 166,175 (2d Cir. 2005) ("[T]he [Bankruptcy] Code not only authorizes the chapter 11 debtor to manage the estate's legal claims, but in fact requires the debtor to do so in a way that maximizes the estate's value"). While the settlement of estate causes of action can play a role in maximizing estate value and minimize the time, expense and uncertainties associated with litigation, the Credit Bid Release provides an outsized benefit to an insider (ESL) at the expense of the Debtors' unsecured creditors.

193. Given the massive delta between the $35 million Release Consideration and the hundreds of millions of dollars that likely would be returned to the estates without the Release, the ESL Sale cannot be the product of good business judgment and cannot survive the heightened scrutiny applicable to releases of the Debtors' insiders.[54]

IV. AN ORDERLY ASSET MONETIZATION AND GOB PROCESS MAXIMIZES VALUE TO THE ESTATES AND CREDITORS

194. All evidence indicates that an orderly asset sale and contemporaneous GOB process run by the Debtors is the best alternative available to the Debtors to maximize value for

[54] The Release also cannot satisfy the standard under Bankruptcy Rule 9019, which requires that a settlement be "fair and equitable," *In re Iridium Op. LLC*, 478 F.3d 452, 464 (2d Cir. 2007), and in the "best interests of the estate." *In re Chemtura Corp.*, 439 B.R. 561, 593 (Bankr. S.D.N.Y. 2010) (citing *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968)). As with a sale to an insider under section 363, courts have subjected settlements with an insider to "closer scrutiny." *See, e.g. In re Drexel Burnham Lambert Grp.*, 134 B.R. 493, 498 (Bankr. S.D.N.Y. 1991). For the same reasons the Release cannot be approved under section 363, it also cannot meet the standard under Bankruptcy Rule 9019 because, among other reasons, the paltry $35 million Release Consideration falls well below the "lowest point in the range of reasonableness." *Id.*

their estates and creditors and, therefore, the ESL Sale should not be approved. *See Consumer News & Bus. Channel P'ship v. Fin. News Network Inc. (In re Fin. News Network Inc.)*, 980 F.2d 165, 169 (2d Cir. 1992) (noting that the "principal responsibility [of the bankruptcy court] is to secure for the benefit of creditors the best possible bid."); *G-K Dev. Co. v. Broadmoore Place Invs., L.P. (In re Broadmoor Place Invs., L.P.)*, 994 F.2d 744, 746 (10th Cir. 1993) (finding that a bankruptcy court has "power to disapprove a proposed sale . . . if it has an awareness there is another proposal in hand which, from the estate's point of view, is better or more acceptable").

195. The Creditors' Committee advocated shortly after its appointment, based on the information available to it at the time, that an orderly wind down of the Debtors' businesses (*i.e.*, GOB sales, a robust real estate marketing process, monetization of various individual assets and component businesses and the pursuit of valuable estate causes of action) represented the best path forward in these Chapter 11 Cases. *See* Supplemental Global Bid Procedures Objection ¶¶ 5-6 (noting that the go forward store business plan is based on unrealistic cost reductions, undetermined working capital or financing needs, while leaving what would be left of the estates administratively insolvent); Simms Decl. ¶¶ 11-19 (attesting that based on the Creditors' Committee's analysis, the incremental cost of pursuing a going concern sale could be over $300 million through February 15). Indeed, it quickly became apparent that any proposed sale to ESL would be nothing more than a dressed-up foreclosure auction at discounted values. The Creditors' Committee's continued diligence and receipt of financial information from the Debtors has only confirmed this view.

196. Nonetheless, at the Auction, the Debtors selected the ESL Bid over the superior alternative of a GOB and wind-down process. In accepting the ESL Bid, the Debtors relied on various assumptions and projections that undervalued the Debtors' assets and inappropriately

increased the extent of the claims that would be allowed against the Debtors' estates in connection with a wind-down scenario to compare with the ESL Sale. As set forth further in the Burian Declaration, a wind-down scenario premised upon a properly run sale process would generate substantial value for the estates over and above the ESL Sale. *See* Burian Decl. ¶ 35 & Ex. B.

A. The Flawed Sale Process Conducted by the Debtors Did Not Result in a Competitive Auction for the Debtors' Assets

197. The Debtors cannot demonstrate that the ESL Sale is in the best interests of the Debtors' estates relative to an orderly GOB process because the Debtors' marketing and auction process was confusing and inadequate from the start. Accordingly, such process provides an insufficient basis to evaluate the bids received, and the Debtors cannot meet their burden to show that they have attained the highest and best price. Burian Decl. ¶¶ 4-7.

1. The Debtors' Process Was Rushed, Disorganized and Confusing, Which Prevented True Market Testing of the Value of the Debtors' Assets

198. Upon filing for bankruptcy, the Debtors were wholly unprepared to conduct a meaningful sale process for individual assets and business lines and have made no serious efforts to do so at any point during these Chapter 11 Cases. That lack of planning and effort damaged the sales process significantly: interested third parties were unable to diligence operating businesses and real estate assets. *Id.* ¶ 16. What should have been a competitive process to maximize value to the estates became a one-horse race to transfer Sears and its valuable assets and operating businesses to ESL, which, with its insider status, was the only party able to understand and diligence the Debtors' various unencumbered assets well enough to submit a bid on the Debtors' extremely accelerated timeline. *Id.* ¶ 17. The Debtors never conducted an auction for individual assets and businesses that could, in sum, have exceeded the ESL Bid. Instead, the Debtors only compared successive ESL bids to hypothetical and conservative wind-

down estimates. The result of this flawed sale process was acceptance of the ESL Bid, which fails to provide appropriate value for unencumbered assets and will plunge the Debtors' estates into administrative insolvency. *Id.* ¶ 7.

199. The Debtors, however, were fully aware of the need for a robust sale process to maximize value to the estates. In 2017, Centerview Partners advised the Debtors that bidders [redacted] during a 2016 sale process conducted by Citibank. The problem then had been that the Debtors had not made any progress towards marketing [redacted]. *Id.* ¶ 15.

200. Rather than heed that warning, the Debtors did virtually no planning with respect to the marketing and sale of their unencumbered assets. Instead, the Debtors retained Lazard on the eve of filing, and neither the Debtors nor Lazard were prepared to run a sale process that would enable third parties to perform the due diligence necessary to evaluate the Debtors as a going concern, the underlying businesses as standalone entities, or the Debtors' real estate assets. *Id.* ¶ 16. The Debtors failed to engage meaningfully with prospective bidders other than ESL, which discouraged potential third-party bidders from participating in the sale process altogether. *Id.* ¶ 18. Only ESL, given its history with and control over Sears, had sufficient information to submit a bid on the timeline necessitated by these proceedings. *Id.* ¶ 17.

201. Further, as described in the Burian Declaration, the real estate marketing process run by the Debtors was flawed in four primary respects. ***First***, the condensed timeline for the process did not allow sufficient time for prospective bidders to evaluate the Debtors' assets and submit bids. Despite the massive undertaking that marketing [redacted] disparate real estate assets would entail, the Debtors, through their advisors at JLL, did not begin their outreach to potential purchasers for their real estates until December 2, 2018, just 26 holiday-filled days before

indicative bids were due on December 28, 2018—and this initial outreach was only for a small number of "non-core" properties. Then, on December 21, 2018—just ***one holiday-shortened week*** before indicative bids were due—JLL launched official marketing websites and datarooms for the full set of the Debtors' real estate assets. The Debtors apparently expected potential bidders—most of whom are local and regional investors—to evaluate the opportunities available and to submit a bid within seven days, including over the Christmas holidays, of receiving access to an inadequate dataroom. It is difficult to conceive how the shortened timetable could permit bidders to engage in the necessary diligence and analysis to make an informed bid or was otherwise conducive to a successful auction for the Debtors' real estate. *Id.* ¶ 23.

202. As described in the report of Ronald Greenspan, a senior managing director of FTI Consulting, Inc. to maximize the realizable value from the Debtors' real estate, the Debtors needed to market to potential buyers by reaching out broadly, providing sufficient time to bid, and making sufficient information available for diligence. Report of Ronald Greenspan, attached hereto as **Exhibit D** (the "Greenspan Report") § F. A true value-maximizing process (or one that would provide information from which one could reach a reasonable conclusion of likely achievable value) typically would occur over a 60 to 120-day period (which is similar to the period that ESL intends to use during the post-Closing "Designation Rights Period" when it will be marketing the Debtors' leases and contracts to third parties for its own benefit). *See* APA § 2.6, Art. V. During that period, brokers would be selected, a data room would be fully populated, email blasts and cold calls would be made and asset tours and other extensive diligence would be conducted, all of which would culminate in competitive negotiations amongst interested parties and execution of purchase agreements. The Debtors' abbreviated real estate process bore none of these characteristics of a well-run sale.

203. ***Second***, the process was disorganized and confusing to potential bidders. Given the abrupt changes to the number of properties the Debtors were marketing, the tight timeframe, and the lack of communication with the market generally, there was considerable confusion over precisely which assets actually were for sale and which assets were subject to the December 28, 2018 deadline. Indeed, members of the Creditors' Committee informed Houlihan Lokey that they did not understand how to submit bids and which properties were for sale. Burian Decl. ¶ 24. Overhanging the entire real estate process was the presence of ESL and the outcome of the going-concern sale process, which had its own competing deadlines and likely depressed bids due to the uncertainty of success. The fact that definitive bids for all of the Debtors' assets were due on the same day as indicative real estate bids created additional confusion. Potential real estate buyers have been highly critical of the lack of information and organization regarding the Debtors' auction, which is reflected in the quality and quantity of the bids and indications of interest received. *Id.*

204. ***Third***, the limited scope of the Debtors' outreach prevented obtaining a true market value from any and all interested parties. Instead, the Debtors contacted only parties who had previously bid on the assets, and in the case of leased assets, certain landlords. This is reflected in a report provided to the Creditors' Committee by the Debtors' advisors on December 18, 2018, only ten days before the indicative bid deadline, indicating that the Debtors had only made [redacted] points of contact in connection with the marketing and sale of [redacted] separate properties. The Debtors' approach necessarily constrained the potential universe of bidders and resulted in fewer and lower bids. Indeed, despite frequent requests, advisors to the Creditors'

Committee were never apprised of any meaningful marketing process undertaken by the Debtors and have serious concerns that no such process ever took place.[55] Burian Decl. ¶ 25.

205. ***Finally***, the Debtors failed to provide sufficient information to allow bidders the opportunity to develop a fully formed view of the properties. At the time of its launch on December 21, 2018, the data room lacked basic information such as individual asset financials and marketing materials. Even as of January 8, 2019, eleven days ***after*** the deadline for indicative bids had passed, the data room was still under construction and did not contain the customary real estate due diligence materials for each property, such as updated title policies with underlying assets, existing surveys, zoning reports and environmental reports. *Id.* ¶ 26. The result of these various deficiencies was that only a small number of potential bidders were aware of what the Debtors were selling, they had limited information on which to base a decision to bid, and they lacked adequate time to evaluate that information and decide whether to bid and how much. The sale process therefore attracted primarily opportunistic buyers who could submit laughably low offers with no cost or penalty, and incentivized stakeholders, particularly landlords, to submit placeholder bids as a means of expressing interest and opening a channel for negotiations. For example, the Debtors received [redacted] bids of either $0 or $1 for entire assets, and only [redacted] bids for a total of [redacted] assets. For the various reasons set forth in the Greenspan Report, these bids provide a grossly insufficient basis for establishing the value of the properties—values that the Debtors further discounted and then incorporated into their recovery analysis to justify the economics of the ESL Sale. *Id.* ¶ 27.

[55] For example, on a December 12, 2018 call with the Creditors' Committee's advisors (just sixteen days before indicative bids were due), it became clear that the Debtors' advisors at JLL still had not developed a marketing strategy or detailed insight into the sale process. And despite the Creditors' Committee's repeated requests and assurances from the Debtors' advisors that marketing and progress reports (including tracking reports and lists of parties contacted) would be forthcoming, they only ever produced one such report.

2. The Debtors Possess Other Highly Valuable and Complex Unencumbered Assets that they Failed To Market Properly

206. Beyond just the valuable real estate portfolio, the Debtors possess numerous unique and fully functioning operating businesses that are complex and cannot be marketed and sold without devoting considerable time and attention, meaningful advance planning, and specialized treatment to the sale process. These include (i) Sears Home Services, (ii) Innovel, (iii) Monark and (iv) other assets. Burian Decl. ¶¶ 10-13. The Debtors likewise failed to engage seriously with third parties to market test these assets.

207. **Sears Home Services ("SHS")**. SHS is a multi-faceted, stand-alone business. SHS is comprised of various sub-business lines including a home warranty business, an appliance repair business, a home improvement and remodeling service, a home improvement/maintenance business and a business known as "Parts Direct" that sells parts for different household appliance brands. [redacted] *Id.* ¶ 10.

208. **Innovel Solutions ("Innovel")**. The Debtors also own Innovel, an end-to-end logistics solutions provider. Innovel provides warehousing, transportation, installation and home delivery services to retail, manufacturing and commercial clients, making more than four million deliveries annually with 1,100 truck on the road daily. Innovel is one of the largest warehousing and transportation networks in the country, capable of providing both last-mile and end-to-end services. [redacted] *Id.* ¶ 11.

209. **Monark Premium Appliance Company ("Monark")**. The Debtors also own Monark. Monark and its affiliates form a nationwide distributor of premium home appliances that serve architects, builders, designers, developers and homeowners. Monark's 20 showrooms

across Arizona, California, Florida and Nevada offer customers a high-end selection of cooking, cooling and cleaning appliances from a variety of brands. [redacted] *Id.* ¶ 12.

210. **Other Assets**. The Debtors possess a variety of other unencumbered assets that should also have been subject to a robust sales process, including the customer data owned by the Debtors and Sears Auto Centers. *Id.* ¶ 13.

211. Two prime examples underscore the consequences of the Debtors' failure to create a clear process to enable potential third-party bids as to these unique and valuable assets of the Debtors. First, on October 17, 2018, [redacted] submitted a fully financed [redacted] offer to be the stalking horse bidder for the Parts Direct business within SHS, along with a marked-up asset purchase agreement and proposed bidding procedures, representing that they had very limited due diligence remaining before their bid could be committed. *Id.* ¶ 19. [redacted] is a strategic buyer uniquely positioned to purchase the PartsDirect business notwithstanding the deficit in information provided by the Debtors. *Id.* Despite this significant offer, the Debtors failed to engage and instead allowed the offer to languish, with [redacted] waiting on the sideline. On December 5, 2018, [redacted] submitted a revised, fully financed stalking horse bid of [redacted]. The Debtors again failed to keep [redacted] engaged or advance the state of negotiations. Ultimately, [redacted] submitted a further revised bid, dropping its proposed purchase price to only [redacted] on December 28, 2018. [redacted] was never afforded an opportunity to actually bid at the Auction despite repeatedly stating its desire and willingness to increase its price if there was more certainty and/or structure around the actual process being run. *Id.* The Debtors' inability to run a proper sale process caused progressively less attractive bids that cost the estates approximately [redacted]—in this example alone. *Id.*

212. As a second example of the failed sale process, [redacted], which was exploring transaction structures related to SHS (including the treatment of protection agreement liabilities), told Houlihan Lokey on January 8, 2019 that they could not obtain the due diligence they required from the Debtors regarding standalone general and administrative expenses. *Id.* ¶ 20. According to [redacted], Lazard had uploaded only ***three*** files regarding those assets to a data room on December 27, 2018, and had provided nothing further since that date. *Id.* [redacted] was unable to move forward with a bid because of its inability to conduct proper due diligence that *any* prospective buyer would require.

213. These are but two examples of the Debtors' failure to conduct a proper section 363 sale process. Had the Debtors conducted a proper sale process, the benefit to the estates would have been maximized.

3. The Poorly Conducted Auction Prevented Third-Party Participation

214. It is no exaggeration to state that no legitimate auction ever took place. Instead, over the course of several days and nights, beginning on January 14, 2019, bilateral negotiations between the Debtors and ESL played out. Burian Decl. ¶ 32. As originally conceived, the Auction was supposed to be a forum where various parties would compete to bid on many if not all of the Debtors' valuable unencumbered assets. That never happened.

215. For example, as this Court is aware, real estate bidders who sought to participate in the Auction on January 14 were told by counsel for the Debtors that they could not even be in the room "as there is no reasonable prospect that such bids will be competitive with an ESL bid." In response, this Court instructed the Debtors that the landlords should be permitted to attend the Auction, make binding bids, which could be aggregated with the value of any additional liquidator bids and the reasonable value of the Debtors' other assets, to compete with ESL. Yet, at the Auction, the Debtors never asked for bids or even engaged with the landlords—the focus,

as usual, was solely on ESL. While the Debtors continued to negotiate exclusively with ESL, third parties who wished to bid for discrete assets literally roamed the offices of Debtors' legal counsel, confused as to whether they would get a chance to bid in a competitive auction. *Id.* ¶ 31.

216. Moreover, the Debtors have refused to engage with prospective bidders following the conclusion of the Auction, including highly qualified bidders that have demonstrated significant interest and the clear financial wherewithal to consummate a transaction that could result in significantly more value for the Debtors' estates and creditors than the value contemplated by the ESL Sale for the same assets. Such refusal is inconsistent with the express terms of the APA and wholly antithetical to the Debtors' fiduciary duties. Specifically, the APA provides, in relevant part, that the ESL Sale is "subject to approval by the Bankruptcy Court ***and the consideration by Sellers of higher or better Competing Transaction***." APA § 8.2(b)(iii) (emphasis added).[56] In addition, the Debtors are free to terminate the APA to the extent they "accept or agree to any Competing Transaction or upon approval by the Bankruptcy Court of, or the filing by or on behalf of any Seller of a motion or other request to approve, a Competing Transaction." *Id*. § 12.1(a)(iii). Finally, the APA includes neither a no-shop provision nor any other form of restriction on the Debtors' ability to consider alternative proposals. Accordingly, and in view of the insider nature of the ESL Sale and the significant execution and credit risk attendant thereto, failing to engage with such potential bidders is inconsistent with the Debtors' fiduciary duty to maximize the value of their estates.

217. And, for reasons unknown, the Debtors failed to comply with the Global Bidding Procedures and consult at critical times during the Auction with the Creditors' Committee. *See*

[56] The APA defines "Competing Transaction" to include any alternative transaction related to the sale of the Debtors' assets or business. *Id*. § 1.1.

Global Bidding Procedures Art. VII.B.3 ("[T]he Debtors, ***after consulting with the Consultation Parties***, shall announce the bid that they believe to be the highest and best offer.").[57] The Debtors therefore did not have the benefit of the Creditors' Committee's position to encourage ESL to improve the terms of the ESL Bid. By declining to abide by the Global Bidding Procedures and conduct a meaningful, competitive auction, the Debtors have failed to maximize value to the estates.

4. Unsurprisingly, ESL Emerged as the Winning Bidder in a One-Horse Race

218. Given the Debtors' extensive focus on negotiations with ESL to the exclusion of potential third-party bidders, it is no surprise that the flawed sale process and Auction concluded with the Debtors accepting the ESL Bid. The Debtors' efforts to court ESL date back at least to December 5, 2018, when ESL submitted an indicative bid (the "ESL Indicative Bid"). The Debtors conducted diligence in respect of the ESL Indicative Bid and discussed such bid with ESL and its advisors, but ultimately determined that it was non-actionable, both legally and financially. Subsequently, on December 28, 2018, ESL submitted a revised bid to acquire substantially all of the Debtors' go-forward retail footprint and other assets and component businesses of Sears. Following submission of ESL's December 28 bid, the Debtors' advisors

[57] The Debtors clearly were aware of their duty to consult with the Consultation Parties (as defined in the Global Bidding Procedures), as evidenced by numerous statements made during the Auction by the Debtors' counsel. *See, e.g.*, Transcript of January 14, 2019 Auction ("Jan. 14 Auction Tr.") 8:17-20 ("Importantly, one of the most important auction rules, the Debtors can modify the rules at any time in consultation with the consultation parties in their reasonable discretion in order to maximize value."); *Id*. at 11:12-16 ("We're going to adjourn the auction, talk with parties, and make that determination after consultation with consultation parties and the restructuring committee, and we hope after further negotiations with the ESL. The record negotiations."); *Id*. at 26:4-9 ("On bid evaluation, the Debtors have the right at the direction of the restructuring committee and subcommittee as applicable in its sole discretion and after consultation with the consultation parties to determine which bid is the highest or otherwise best bid."); *see also* Jan. 15 Auction Tr. 40:11-19 ("[W]e decided late last night to allow ESL overnight to put together a response to the proposal from the debtors, and at this time, we will have them put that proposal on the record, after which time we are going to take a break, go discuss it with the restructuring committee and the consultation parties."); *Id*. at 75:6-17 ("[W]e will have a brief adjournment just for the restructuring committee to consider the proposal that has been made on the record and we will come back on with the restructuring committee's decision. . . . I should have added and will consult with the consultation parties before coming back on record.") (internal quotations omitted).

engaged with ESL and its advisors to discuss the infirmities of the bid, ultimately determining that this bid was also not actionable. Burian Decl. ¶ 29. At that time, the Debtors indicated that they intended to pivot to a wind-down process, but continued to negotiate with ESL. On January 9, 2019, ESL submitted a revised bid attempting to remedy the deficiencies in its prior two bids. But as with ESL's prior bids, all parties, including the Debtors, agreed that this bid would have left the Debtors administratively insolvent. Nevertheless, the Debtors continued to engage in "around the clock" negotiations with ESL over the proposed bid. *Id.* ¶ 30.

219. The Debtors' negotiations with ESL continued up to and throughout the Auction as well, again to the exclusion of any potential third party bidders and despite the constant shortcomings with ESL's various bids. Even as of January 15, 2019, the Debtors' counsel stated that "the [ESL Bid] is not otherwise higher or better when compared to the company's alternatives. There are a number of significant problems that the company has with the ESL bid and we have tried, and I want to say, so very hard to get there with this deal." Jan. 15 Auction Tr. 50:23-51:10. The Debtors' counsel went on to explain that among these infirmities was the insufficient cash available to get the Debtors to Closing. *Id*. at 52:2-10.

220. Similarly, counsel for the Restructuring Subcommittee determined that "***substantial claims exist against ESL and its affiliates, as well as other defendants***." *Id*. at 63:12-21, 64:4-11 (emphasis added). Counsel for the Restructuring Subcommittee went on to explain that "***any benefits of the ESL transaction are ephemeral*** for the reasons that [Debtors' counsel] articulated and that the company does not have sufficient cash to close the transaction." *Id*. at 66:3-15 (emphasis added).

221. In the early hours of January 16 (fewer than twelve hours after admitting an all but certain impasse), however, the Debtors came back on the record to report that

notwithstanding the numerous "significant" deficiencies inherent in the ESL Bid and their utter inability to achieve an actionable resolution for weeks prior, they miraculously had determined to accept the ESL Bid. In support of the "revised" ESL Bid, ESL's counsel again touted certain additional consideration that had been added to the purchase price. *See id*. 72:14-73:14.

222. The Debtors have explained that the primary driver of their decision to accept the ESL Bid—when they had just rejected a substantially similar bid hours earlier—was that the new ESL Bid included an agreement by [redacted] to purchase and subsequently roll over the entire outstanding Junior DIP Facility. Burian Decl. ¶ 33. In the Debtors' view, [redacted] agreement remedied an existing $120 million shortfall, thereby bringing the Debtors close enough (but not all the way there) to administrative solvency to justify proceeding with the ESL Bid. The Debtors' position, however, is misguided because this alleged improvement to the ESL Bid generated zero additional value for the benefit of the estates. Instead, the entirety of the $120 million in Junior DIP Facility serves only to bridge the estates to the closing date for the ESL transaction and provides no incremental value to the estates. Put differently, this touted "improvement" in the ESL Bid benefits ESL alone and is no different for the Debtors' estates than if the Debtors simply had rejected the ESL Bid and pivoted to an orderly wind-down. This is evidenced by the Debtors' analysis of an orderly wind-down scenario, which projects only [redacted] of draws on the Junior DIP Facility versus $350 million required to be drawn to fund the closing of the ESL Bid. *Id.* As a result, the Debtors' unsecured creditors are paying [redacted] through the consumption of unencumbered assets to satisfy the additional [redacted] of borrowings under the Junior DIP Facility that are being incurred for ESL to consummate the insider ESL Sale. This [redacted] rightfully belongs to the Debtors'

unsecured creditors, who are being left with up to $35 million in cash and fewer causes of action to pursue to remedy ESL's wrongs.

223. Ultimately, the Debtors never seriously pursued or entertained any alternative to ESL even though ESL never corrected the infirmities with its bids—including certain fundamental problems that are described in greater detail in the presentation attached to the Burian Declaration. *Id.* ¶ 32 & Ex. B.

B. The Debtors Relied on Unsupported Assumptions in Comparing the ESL Sale to the Wind-Down

224. In declining to pursue a GOB process, the Debtors relied upon a flawed liquidation analysis that assumed, among other things, (i) artificially depressed valuations for their unencumbered real estate assets; (ii) the existence of $331 million of unproven—and unprovable—superpriority claims under Bankruptcy Code section 507(b) ("507(b) Claims") that ESL threatened to assert in a liquidation scenario, but would agree to limit the assertion of certain scenarios if the Debtors accepted its "going concern" bid;[58] and (iii) an inexplicable decision not to surcharge collateral under Bankruptcy Code section 506(c). These faulty assumptions and legal conclusions resulted in an analysis that grossly understates the realizable value in a wind-down scenario and inflates administrative expense claims.

1. The Debtors Undervalued the Unencumbered Real Estate Assets by Using Flawed Methodology

225. In large part owing to the flawed sales process described above, the Debtors substantially undervalued their real estate assets in connection with determining potential

[58] ESL shall have no right to receive proceeds from litigation regarding Seritage, Land's End or other acts of intentional misconduct on behalf of any 507(b) Claim or deficiency claim. In addition, ESL shall not be entitled to receive in excess of $50 million on account of its 507(b) claims, if any, from the proceeds of any other Claims or causes of action of the Debtors' estates, with any ESL 507(b) Claims in excess thereof being treated as general unsecured claims that are to receive pro rata recoveries with general unsecured claims. *See* APA § 9.13(c).

recoveries to creditors under a wind-down scenario. They then included their undervalued and inaccurate real estate valuations in the wind-down analysis they relied upon to justify their selection of the ESL Bid. As discussed in greater detail in the Greenspan Report, the Debtors committed three primary errors in their real estate valuation.

226. ***First***, the Debtors [redacted]

227. ***Second***, [redacted]

[redacted]. [redacted]. [redacted]. *Id.*

228. ***Third***, the Debtors [redacted] *Id.*

229. As a result of these and other errors discussed at greater length in the Greenspan Report and below, the Debtors' estimated proceeds from their real estate dispositions of [redacted] was misleadingly low. The Greenspan Report corrects the valuation errors and excessive discounting, concluding that the properties should have been valued based on proper, industry-standard valuation techniques. To arrive at his estimates, Greenspan used the appropriate market

values for the properties. He did this by first using all of the appraisals and value estimates performed by the Debtors' professionals as follows: (i) using the 2018 and 2019 JLL appraisals; (ii) if no JLL appraisal existed, using the A&G 2018 value estimates; (iii) if no JLL appraisals or A&G value estimates existed, using 2017 and 2018 Cushman & Wakefield appraisals; (iv) if no appraisal values existed at all, using JLL broker valuations; and (v) if no value estimates by the Debtors' professionals were available, employing commonly-accepted portfolio valuation techniques such as discounted cash flow, direct capitalization, and/or the sale comparison approach. *Id*. Having determined this "market value" ([redacted] of which was determined by the Debtors' professionals), Greenspan then applied a liquidation discount in light of the fact that the properties would be disposed in an orderly wind-down process. *Id.* The amount of that liquidation discount varies based on ownership and property type, ranging from 0% to 60% with an overall average discount range of 15 to 35%. *Id.* Greenspan's approach is consistent with well-recognized real estate appraisal techniques, unlike the Debtors' [redacted] *Id*.

230. Once the Debtors' valuations are corrected based on these industry-standard techniques, the Debtors' properties should have estimated proceeds of [redacted] (using the mid-point estimate). *Id*. Of that [redacted], [redacted] is attributable to unencumbered real estate and [redacted] is attributable to encumbered real estate. *Id.* When these inputs are inserted into the Debtors' waterfall analysis, the difference is striking—a delta of [redacted] from the Debtors' analysis. Burian Decl., Ex. B, at 13-14.

2. ESL Cannot Prove Its Entitlement to a Claim Pursuant to Bankruptcy Code Section 507(b)

231. The Debtors' wind-down analysis also assumes that in a liquidation scenario, ESL would be entitled to [redacted] in superpriority adequate protection claims under section 507(b) of the Bankruptcy Code (a "507(b) Claim"). This claim amount should be $0. Indeed, under well-established case law, ESL is not entitled to a 507(b) Claim at all.

232. To demonstrate entitlement to a 507(b) Claim, a secured creditor must prove that its collateral has diminished in value as a result of (i) the stay of action against such property, (ii) the use, sale or lease of such property or (iii) the granting of a lien under Bankruptcy Code section 364(d) during the bankruptcy case, despite the creditor's receipt of adequate protection. *See* 11 U.S.C. § 507(b);[59] *LNC Invs., Inc. v. First Fid. Bank, N.A.*, 247 B.R. 38, 44-45 (S.D.N.Y. 2000); *see also Qmect, Inc. v. Burlingame Capital Partners II, L.P.*, 373 B.R. 682, 690 (N.D. Cal. 2007) (finding that creditors were not entitled to recover on replacement liens granted as adequate protection absent proof that collateral diminished in value as a result of the bankruptcy case).

233. The allowed amount of a 507(b) Claim is determined by calculating the diminution in the value of the secured creditor's collateral from the petition date, less the value conferred by adequate protection during the bankruptcy case. *See Chase Manhattan Bank USA NA v. Stembridge* (*In re Stembridge*), 394 F.3d 383, 387-88 (5th Cir. 2004) (finding diminution

[59] Bankruptcy Code section 507(b) provides:

> If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and ***if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(2) of this section*** arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

11 U.S.C. § 507(b) (emphasis added).

in value is the amount of the relevant asset's decrease in value from the petition date, less any adequate protection payments received during the pendency of the case).

234. The secured creditor must further establish that the diminution in value is an allowable claim under Bankruptcy Code section 507(a)(2), which further references Bankruptcy Code section 503(b). 11 U.S.C. § 507(b). In other words, the diminution in value must constitute an administrative expense as a necessary cost of preserving the estate. *Ford Motor Credit Co. v. Dobbins*, 35 F.3d 860, 865-66 (4th Cir. 1994); *LNC Invs., Inc. v. First Fid. Bank, N.A.*, No. 92 Civ. 7584 (MBM), 1997 U.S. Dist. LEXIS 12858, at *12 (S.D.N.Y. Aug. 27, 1997); *In re Mary Holder Agency, Inc.*, No. 11-34280 (MBK), 2012 WL 4434362, at *2-3 (Bankr. D.N.J. Sept. 24, 2012); *In re Quality Beverage Co., Inc.*, 181 B.R. 887, 897 (Bankr. S.D. Tex. 1995).

235. A secured creditor bears the burden of proof with respect to establishing its entitlement to a 507(b) Claim. *Bank of N.Y. Trust Co. NA v. Pac. Lumber Co. (In re Scopac),* 624 F.3d 274, 284 (5th Cir. 2010), *modified*, 649 F.3d 320 (5th Cir. 2011) ("The [secured] Noteholders had the burden to prove their entitlement to a [Bankruptcy Code section] 507(b) priority claim.") (citing *Dobbins,* 35 F.3d at 866); *In re Constr. Supervision Servs., Inc.*, No. 12–00569–8 (SWH), 2015 WL 4873062, at *5 (Bankr. E.D.N.C. Aug. 13, 2015) ("The party seeking superpriority status bears the burden of proving entitlement to a [Bankruptcy Code section] 507(b) priority claim.") (citing *Official Comm. of Unsecured Creditors v. UMB Bank, N.A (In re Residential Capital, LLC)*, 501 B.R. 549, 590-91 (Bankr. S.D.N.Y. 2013)).

236. ESL has not proved, and indeed cannot prove, its entitlement to ***any*** 507(b) Claim, and the Debtors have failed to explain why they included such a superpriority claim in

their analysis of the various alternatives. In fact, the Debtors themselves agreed that an ESL 507(b) Claim should not be included in the analysis:

> While ESL acknowledges that infirmity in the bid, they suggest that the company would be administratively insolvent in a wind-down. That is not the analysis of the subcommittee or its advisors, and it's predicated on the threat of a significant administrative [507(b)] claim to be asserted by ESL ***when this company has engaged in bankruptcy and incurred substantial losses for the purpose of trying to enable a going concern bid by ESL***.

Jan. 15 Auction Tr. 66:16-67:3 (emphasis added).

237. The only possible trigger underlying ESL's claim to 507(b) entitlement would be that the use, sale or lease of ESL's prepetition collateral diminished and the adequate protection provided was insufficient. This argument would fail. The Debtors' use of the proceeds from the DIP ABL Facility to satisfy claims and finance the Chapter 11 Cases was foreseeable and agreed upon by ESL. Indeed, the Debtors' sale process, and these Chapter 11 Cases generally, have been run primarily for ESL's benefit and, as such, ESL is not entitled to any 507(b) Claim. *See In re Franklin Indus. Complex Inc.,* No. 01-67457 (SDG), 2008 WL 3992233, at *6-7 (Bankr. N.D.N.Y. Aug. 21, 2008) (denying a secured creditor's 507(b) Claim because there was no evidence before the court showing diminution in the collateral's value and observing that "there is a reluctance to grant superpriority status if the claimed losses were ***occasioned by the creditor's own conduct***.") (emphasis added); *Quality Beverage*, 181 B.R. at 897 (disallowing section 507(b) claim where court found that diminution claim resulted from creditor's ***self-interested business decision*** not to foreclose on collateral); *In re Callister*, 15 B.R. 521, 528 (Bankr. D. Utah 1981) (finding that a superpriority claim is intended to "recapture value ***unexpectedly*** lost during the course of a case") (emphasis added); *Cheatham v. Cent. Carolina Bank & Trust Co., N.A., (In re Cheatham)*, 91 B.R. 382, 386 (Bankr. E.D.N.C. 1988) (citing

Callister, 15 B.R. at 531-34) ("[S]uperpriority status is not available where the creditors [*sic*] loss . . . is due to ***ordinary or foreseeable depreciation***.") (emphasis added).

238. As the details of the sale process make clear, it was run to accommodate one buyer: ESL. Had the Debtors pivoted to the GOB process at the commencement of these cases, as the Creditors' Committee urged, there would be more value for the estates. ESL cannot claim that any decline in the value of collateral was "unforeseeable" or "unexpected" when ESL was the party solely responsible for the Debtors' pursuit of a going concern sale. *See, e.g.*, Oct. 15, 2018 Hr'g Tr. 26:24-25 ("We've been in negotiations with one likely bidder, which is ESL."); Evercore Reply ¶ 4 (stating that "ESL may be the only bidder for the Debtors' assets on a going-concern basis.").

239. Moreover, ESL cannot establish that the diminution in the value of its collateral constitutes a legitimate administrative expense, as required by Bankruptcy Code section 507(b), because it is not a necessary cost of preserving the value of the Debtors' estates. In fact, the only reason for the diminution in value to ESL's collateral (to the extent any diminution has occurred) would be ESL's self-interested decision to keep the Debtors out of an orderly liquidation in order to buy time to make a bid for the Debtors' assets through the going concern sale process. It would be entirely inequitable to force the estates and unsecured creditors to bear the costs of ESL's conduct. *See e.g.*, *Quality Beverage*, 181 B.R. at 897. As such, the inclusion of any ESL 507(b) Claim in the Debtors' wind-down analysis disproportionately and improperly deflates value available to creditors through a GOB process and cannot support the Debtors' determination that the ESL Sale was highest and best. The Debtors' wind-down analysis should be adjusted downward to exclude ESL 507(b) Claims in the amount of [redacted]. Burian Decl., Ex. B, at 14.

3. The Debtors Inexplicably Failed to Surcharge Collateral Pursuant to Bankruptcy Code Section 506(c)

240. The purpose for the surcharge of costs and expenses against a secured creditor's collateral under Bankruptcy Code section 506(c)[60] is "the ***prevention of a windfall to the secured creditor***; a secured creditor should not reap the benefit of actions taken to preserve the secured creditor's collateral without shouldering the costs." *In re Kohl*, 421 B.R. 115, 123 (Bankr. S.D.N.Y. 2009) (citing 4 COLLIER ON BANKRUPTCY ¶ 506.05) (emphasis added). In order to surcharge collateral, a debtor bears the burden of demonstrating that (i) the expenses sought to be surcharged against the collateral were necessary to preserve or dispose of the secured creditor's collateral, (ii) the amounts expended were reasonable and (iii) the expenses were incurred for the direct and primary benefit of the secured creditor. *Gen. Elec. Credit Corp. v. Peltz (In re Flagstaff Foodservice Corp.)*, 762 F.2d 10, 12 (2d Cir. 1985) ("*Flagstaff II*"); *In re McLean Indus., Inc.*, 84 B.R. 340, 350 (Bankr. S.D.N.Y. 1988). Expenses may also be surcharged where the secured creditor expressly or impliedly consented to bear such expenses. *Gen. Elec. Credit Corp. v. Levin & Weintraub (In re Flagstaff Foodservice Corp.)*, 739 F.2d 73, 77 (2d Cir. 1984); *In re Croton River Club, Inc.*, 162 B.R. 656, 659 (Bankr. S.D.N.Y. 1993).

241. Generally, an expenditure is "necessary" if it was unavoidably incurred in the preservation or disposal of collateral of the secured creditor. *In re Ware*, 12-30566-KLP, 2014 Bankr. LEXIS 2437, at *17-18 (Bankr. E.D. Va. June 3, 2014); *In re Combined Crofts Corp.*, 54 B.R. 294, 297 (Bankr. D. Wisc. 1985). An expenditure is "reasonable" if it is "in some sensible proportion to the value of the benefit received." *First Servs. Grp., Inc. v. O'Connell (In re*

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[60] Bankruptcy Code section 506(c) provides:

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property.

11 U.S.C. § 506(c).

Ceron), 412 B.R. 41, 52 (Bankr. E.D.N.Y. 2009). Lastly, there must be evidence of the direct, non-incidental benefit provided to the secured creditor rather than suggestions of "possible or hypothetical benefits." *Flagstaff II*, 762 F.2d at 12.

242. Here, the Debtors' wind-down analysis employs a questionable methodology that fails to account appropriately for the availability of various surcharges against the collateral of the Debtors' secured creditors. Specifically, the Debtors estimate gross administrative expense claims through completion of the wind-down process of approximately [redacted]. Burian Decl., Ex. B, at 15. The Debtors estimate that the sale of the unencumbered assets through liquidation will yield proceeds of approximately [redacted]—$[redacted] of which is allocated to the wind-down reserve (pursuant to the Final DIP Order) and [redacted] to repayment of the Junior DIP Facility. *Id.* at 16. Then, without explanation, and contrary to the position taken in all of their prior wind-down analyses, the Debtors allocate all of the remaining [redacted] in unencumbered asset sale proceeds to payment of administrative expense claims, which would deplete entirely the remaining value of the unencumbered assets. *See id.* The Debtors then apply a surcharge of [redacted], in respect of the remaining administrative claims not satisfied by unencumbered assets, against the ABL Collateral,[61] which the Debtors estimate will yield proceeds of approximately [redacted] in an orderly liquidation. *Id.* at 13, 16. Therefore, the Debtors' allocation methodology results in the complete depletion of unencumbered assets even though the majority of the administrative expenses incurred are directly related to the monetization of the ABL Collateral. These expenses are properly surcharged against the second lien lenders, who did not have the benefit of a waiver of Bankruptcy Code section 506(c).

[61] The Debtors' Wind-down Analysis also reflects a charge of [redacted] against the ABL Collateral for the professional fee carve-out.

243. The Debtors' allocation inappropriately shifts the burden of these Chapter 11 Cases onto unsecured creditors. As set forth in the Burian Declaration and as referenced in the chart below, in a wind-down scenario, the Debtors should apply an additional surcharge against the ABL Collateral of approximately [redacted] on account of necessary costs and expenses to be incurred in disposing of (and preserving the value of) the ABL Collateral (after payment in full of the DIP ABL Facility and the non-ESL First Lien Facility and the Stand-Alone L/C Facility). *Id.* at 14.

[redacted]

244. The Debtors' allocation of administrative expense claims appears to be calculated to deplete unencumbered asset value artificially in an effort to make the ESL Sale appear more attractive than a wind-down scenario, while also preserving value for repayment of the Second Lien Facility and ensuring such facility can be used to credit bid in connection with the ESL Sale. Moreover, the Debtors' Wind-down Analysis fails to properly surcharge the direct, quantifiable costs that were incurred, and will continue to be incurred, primarily to benefit secured creditors and should be properly surcharged against such creditors' collateral in accordance with applicable law. *See In re Ware*, 2014 Bankr. LEXIS 2437, at *17-18. In turn, the Debtors' construct would result in a proscribed "wind fall to secured creditors" of hundreds of millions of dollars from avoiding surcharges that should properly be applied to the collateral securing their claims in the event of a wind-down." *Se In re Kohl*, 421 B.R. at 123.

245. Such a result in the wind-down scenario would be grossly inequitable to unsecured creditors, who would be forced to bear the bulk of the administrative expenses that the

Debtors have incurred over the course of these Chapter 11 Cases and in connection with the monetization of secured creditors' collateral and which are a ***direct result of pursuing a going-concern option primarily for ESL's benefit***, the holder of nearly all of the claims in the Second Lien Facility. *Flagstaff II*, 762 F.2d at 12 (holding that a debtor must show that funds were expended primarily for the benefit of the secured creditor, which creditor benefited directly); *see also U.S. v. Boatmen's First Nat'l Bank*, 5 F.3d 1157, 1160 (8th Cir. 1993) (stating that secured creditor should bear the burden of administrative expenses that are incurred to preserve going concern value for benefit of secured creditor). To allow ESL to avoid the costs of pursuing an unsuccessful option (in the event of a wind-down) while reaping the residual benefits is wholly antithetical to the policies underlying the Bankruptcy Code. As set forth in the Burian Declaration, a proper allocation of administrative expenses results in at least a [redacted] increase in recoveries for unsecured creditors[62] (and approximately an [redacted] increase in recoveries for unsecured creditors after proper asset value adjustments), further demonstrating that the ESL Sale does not represent the highest and best alternative for the Debtors' assets. Burian Decl., Ex. B, at 19.

C. Analysis of an Alternative Sale Process Confirms that an Asset Monetization and GOB Process Maximizes Value

246. The marketing and sale process run by the Debtors during these Chapter 11 Cases was laden with flaws, and their wind-down analysis—which leaves unsecured creditors with no recovery—is understated as a result. By contrast, a properly conducted wind-down process will yield higher and better results than the ESL Sale, which will, in turn, enable the Debtors to distribute to their unsecured and true third-party creditors the value to which they are entitled.

[62] Recoveries referenced are without taking into account substantial litigation proceeds that would be received in connection with the claims and causes of action against Lampert and ESL that are to be released as part of the ESL Sale.

As explained in the Burian Declaration and the Greenspan Report, a robust sale process would enable the Debtors to market their real asset assets and business lines more effectively without the overhang of ESL to depress interest from potential bidders.

247. The chart below compares the three recovery analysis scenarios. The first is the ESL Bid, which depicts the recoveries anticipated as a result of the ESL Bid as [redacted]. Of note, [redacted], the ESL Bid leaves the estate administratively insolvent. *See supra* Objection, Part II.B. The second is the "Alternative Sale Process," which shows a recovery analysis based on an orderly sale of assets. This Alternative Sale Process recovery [redacted] As described in detail above, however, this analysis relies on flawed assumptions and valuations. The third analysis, the "Adjusted Alternative Sale Process," fixes those flaws. Prepared by the Creditors' Committee's advisors, the Adjusted Alternative Sale Process makes three essential adjustments to the Debtors' Alternative Sale Process recovery analysis—correcting the concerns detailed above. ***First***, the analysis allocates expenses incurred for the benefit of the ABL Collateral to the ABL Collateral through a surcharge pursuant to Bankruptcy Code section 506(c) against secured creditors that did not have the benefit of a 506(c) waiver under prior Court orders. The Debtors' recovery analysis allocated a disproportionate amount of claims to unencumbered assets by failing to surcharge such collateral. ***Second***, the Adjusted Alternative Sale Process recovery analysis reduces the value assigned to certain claims. Specifically, it reduces the value tied to 507(b) Claims asserted by ESL—scheduled at [redacted] in the Debtors' analysis—to $0. ***Third***, the Adjusted Alternative Sale Process recovery analysis provides more accurate and substantiated values for certain assets. For example, as

described above, the Debtors grossly undervalue the unencumbered real estate in their analysis by [redacted]. Burian Decl., Ex. B, at 9, 14.

[redacted]

248. Based on the adjusted analysis, taking into account more reasonable valuations of key assets, including real estate, and incorporating more appropriate assumptions regarding claims under Bankruptcy Code section 507(b) and collateral surcharge, the wind-down results in a [redacted] recovery to unsecured creditors. *Id.* at 9. This is a far superior outcome than the ESL Sale, which provides no recovery for unsecured creditors and leaves the Debtors' estates administratively insolvent.

V. ESL IS NOT ENTITLED TO THE PROTECTIONS OF BANKRUPTCY CODE SECTION 363(M) OR RELIEF FROM THE AUTOMATIC 14-DAY STAY REQUIRED BY BANKRUPTCY RULE 6004(H)

249. Bankruptcy Code section 363(m) provides that a purchaser or lessee of property of the estate is protected from the effects of a reversal or modification on appeal of the authorization to sell or lease as long as the purchaser acted in good faith and the appellant failed to obtain a stay of the sale pending appeal. This Court should reject not only the Debtors' request for an express finding that the "[t]he Buyer is a good faith purchaser within the meaning

of section 363(m)," but also its related request to deprive the Creditor's Committee of the opportunity to seek a stay pending appeal. Proposed Sale Order ¶¶ 39, 41.

250. Although the Bankruptcy Code does not define "good faith," the Second Circuit has "adopted a traditional equitable definition: one who purchases the assets for value, in good faith and without notice of adverse claims." *In re Gucci*, 126 F.3d 380, 390 (2d Cir. 1997) (citation and internal quotation marks omitted). Typically, lack of good faith is evidenced by fraud, collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders. *See, e.g.*, *In re General Motors Corp.*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009). "The requirement that a purchaser act in good faith . . . speaks to the integrity of his conduct in the course of the sale proceedings." *In re Abbotts Dairies, Inc.*, 788 F.2d 143, 147, 14 C.B.C.2d 811 (3d Cir. 1986). Particularly relevant here, in considering whether a sale is in "good faith" under Bankruptcy Code section 363(m), courts may consider whether a potential purchaser is an insider of the debtor. *See In re After Six, Inc.*, 154 B.R. at 883 (purchaser's lack of connections with debtor is factor supporting finding of "good faith").

251. The proponent of good faith carries the burden to show good faith. *See* 3 COLLIER ON BANKRUPTCY ¶ 363.11. ("The burden of proof to show good faith is on the proponent of good faith, usually the party seeking dismissal of the appeal; it may not be assumed.").

252. The Debtors and ESL have not satisfied that burden here. Indeed, nothing in the proposed sale order or the Sale Notice substantiates the bald assertion that ESL is a good-faith purchaser. *See* Proposed Sale Order ¶ 39. For good reason: the evidence shows that ESL is anything but a good-faith purchaser. As explained *supra*, ESL's actions prior to and during the Chapter 11 Cases, taken together with its status as an "insider" of the Debtors, confirm beyond

doubt that ESL has not conducted itself in good faith and thus is not entitled to a finding of statutory mootness under Bankruptcy Code section 363(m).

253. Nor should the Court waive the automatic 14-day stay period required by Bankruptcy Rule 6004(h). Under Bankruptcy Rule 6004(h), any "order authorizing the use, sale, or lease of property other than cash collateral is stayed until expiration of 14 days after entry of the order, unless the court orders otherwise." Fed. R. Bankr. P. 6004(h)

254. The Advisory Committee Notes to the Rule make abundantly clear that "the purpose of Bankruptcy Rule 6004(h) is to provide sufficient time for an objecting party to request a stay pending appeal before the order can be implemented." 10 COLLIER ON BANKRUPTCY ¶ 6004.11. As is true here, "[a] short period of time is often needed and essential to an objecting party intending to appeal because, if the sale is closed in the absence of a stay, any appeal by an objecting party may well be moot" under section 363(m) of the Bankruptcy Code. *Id.* (citing 11 U.S.C. § 363(m) and supporting cases). Accordingly, "if an objection has been filed and is overruled, the court should eliminate or reduce the 14-day stay period *only* upon a showing that there is a sufficient business need to close the transaction within the 14-day period and the interests of the objecting party . . . are sufficiently protected." *Id.* (emphasis added) (citing cases); *see also id.* ("If the objecting intends to appeal and seek a stay, the stay period should not be reduced to less than an amount of time sufficient to allow the objecting party to seek a stay, unless the court determines that the need to proceed sooner outweighs the objecting party's interests.").

255. There is no basis in the record to depart from this general rule, should this Court approve the ESL Sale. The Debtors and ESL urge the Court to find that "[t]ime is of the essence in closing the Sale Transaction and the Debtors and Buyer intend to close the Sale Transaction as

soon as practicable." Proposed Sale Order ¶ 41. But they offer no basis for that naked assertion. *See In re PSINet Inc.*, 268 B.R. 358, 379 (Bankr. S.D.N.Y. 2001) (declining to waive automatic stay period where, as here, "Debtors made no evidentiary showing of a business exigency requiring a closing within" the stay period" and where, as here, "the Motion contained no more than a contention that the [stay] period should be eliminated . . . and a generalized assertion that the Debtors require 'an expedited closing'"). To the extent the APA attempts to manufacture exigency by contemplating consummation soon after the sale hearing, notably the APA does not impose that consummation must occur by a certain date as a condition of the ESL Sale; rather, it expressly contemplates that a party can *choose* whether to terminate the APA in the event that the sale order is stayed as of February 8, 2019.

256. Ultimately, by urging this Court to make a premature (and unwarranted) finding of statutory mootness under section 363(m)—an issue that is ultimately for the appellate court to decide—through an unsubstantiated "good faith" finding and an unjustified waiver of the ordinary 14-day automatic stay, the Debtors and ESL effectively invite this Court to deprive the Committee of its well-established right to obtain appellate review. *See In re Adelphia Commc'ns Corp.* , 361 B.R. 337, 349-350 (S.D.N.Y. 2007) (holding that objecting parties "have a right to appellate review" and that "there is a significant public interest in vindicating the rights of the minority and preventing the will of the majority to go unchecked by appellate review") (citation and internal quotation marks omitted). This Court should reject that transparent effort to curtail the Creditor Committee's (and other objectors') appellate rights.

CONCLUSION

257. For the reasons set forth herein, the Debtors have not met their burden of demonstrating that the ESL Sale is in the best interest of the Debtors' estates and creditors. Even if the Debtors were entitled to deference under the guise of "business judgment" (which they are not), the ESL Sale still would fail. Not only is the ESL Sale premised on an impermissible credit bid of over $1.3 billion and an unrealistic and unreasonable business plan for Sears NewCo, the terms of the sale are nothing more than an illusory one-way option for ESL to acquire the Debtors' assets while leaving the Debtors' estates administratively insolvent and without satisfying outstanding obligations or, at best, poised for a chapter 22 filing in the near term. The ESL Sale would leave the Debtors administratively insolvent, while depriving the Debtors' unsecured creditors and all of the Debtors' true third-party creditors of value to which they are entitled and would receive through (i) properly conducted GOB sales, (ii) the monetization of valuable real estate by way of a market-based sale process and (iii) the pursuit of viable causes of action. Accordingly, this Court should (i) deny the ESL Sale in its entirety and (ii) grant such other relief as it deems just, equitable and proper.

New York, New York
Dated: January 26, 2019

AKIN GUMP STRAUSS HAUER & FELD LLP

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Exhibit A

Burian Declaration

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
SEARS HOLDINGS CORPORATION, *et al.*,	:	Case No. 18-23538 (RDD)
Debtors.[1]	:	(Jointly Administered)

DECLARATION OF SAUL BURIAN IN SUPPORT OF THE OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS TO ESL INVESTMENTS, INC.

January 26, 2019

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are as follows: Sears Holdings Corporation (0798); Kmart Holding Corporation (3116); Kmart Operations LLC (6546); Sears Operations LLC (4331); Sears, Roebuck and Co. (0680); ServiceLive Inc. (6774); SHC Licensed Business LLC (3718); A&E Factory Service, LLC (6695); A&E Home Delivery, LLC (0205); A&E Lawn & Garden, LLC (5028); A&E Signature Service, LLC (0204); FBA Holdings Inc. (6537); Innovel Solutions, Inc. (7180); Kmart Corporation (9500); MaxServ, Inc. (7626); Private Brands, Ltd. (4022); Sears Development Co. (6028); Sears Holdings Management Corporation (2148); Sears Home & Business Franchises, Inc. (6742); Sears Home Improvement Products, Inc. (8591); Sears Insurance Services, L.L.C. (7182); Sears Procurement Services, Inc. (2859); Sears Protection Company (1250); Sears Protection Company (PR) Inc.(4861); Sears Roebuck Acceptance Corp. (0535); Sears, Roebuck de Puerto Rico, Inc. (3626); SYW Relay LLC (1870); Wally Labs LLC (None); SHC Promotions LLC (9626); Big Beaver of Florida Development, LLC (None); California Builder Appliances, Inc. (6327); Florida Builder Appliances, Inc. (9133); KBL Holding Inc. (1295); KLC, Inc. (0839); Kmart of Michigan, Inc. (1696); Kmart of Washington LLC (8898); Kmart Stores of Illinois LLC (8897); Kmart Stores of Texas LLC (8915); MyGofer LLC (5531); Sears Brands Business Unit Corporation (4658); Sears Holdings Publishing Company, LLC. (5554); Sears Protection Company (Florida), L.L.C. (4239); SHC Desert Springs, LLC (None); SOE, Inc. (9616); StarWest, LLC (5379); STI Merchandising, Inc. (0188); Troy Coolidge No. 13, LLC (None); BlueLight.com, Inc. (7034); Sears Brands, L.L.C. (4664); Sears Buying Services, Inc. (6533); Kmart.com LLC (9022); and Sears Brands Management Corporation (5365). The location of the Debtors' corporate headquarters is 3333 Beverly Road, Hoffman Estates, Illinois 60179.

1. I am a Managing Director in Houlihan Lokey's Financial Restructuring Group and also Head of Houlihan Lokey's Real Estate Strategic Advisory Group. I have been an investment banker at Houlihan Lokey for 17 years. During that time, I have represented more than 35 companies in distressed situations that have successfully reorganized or were sold as going concerns. I have also represented creditor groups in more than 20 situations, including official committees of unsecured creditors and ad hoc groups of secured and unsecured lenders and noteholders, and even official committees of equity security holders.

2. In these chapter 11 cases, I have served as the financial advisor for the Official Committee of Unsecured Creditors of Sears Holdings Corporation, et al. (the "Creditors' Committee"). In this role, I and/or members of my team that I supervise, have interacted with, among others, the Debtors, the Restructuring Committee of the Board of Directors of Holdings[2] (the "Restructuring Committee"), the Restructuring Subcommittee of the Restructuring Committee (the "Restructuring Subcommittee"), ESL Investments, Inc. ("ESL"), various prospective bidders and each of their respective advisors.

3. In this role, I have, among other things, attended numerous meetings, participated in dozens of conference calls, and had countless individual phone and in-person communications with the various stakeholders in the estates at issue in these chapter 11 cases. I have been made aware of the sale process run by the Debtors' financial advisors, and have held meetings and calls with the Debtors and their advisors to understand how that process was run and the outcomes of their marketing effort as it was ongoing. My calls and meetings with the Debtors and their advisors have been ongoing throughout the course of these chapter 11 cases and have allowed me to remain

[2] Capitalized terms used and not otherwise defined in this Declaration shall have the meanings ascribed to such terms in the Objection.

informed of the events and processes that I describe in this declaration. I have held conversations and meetings with prospective bidders for certain of the Debtors' assets and their respective advisors, and members of my team participated in due diligence sessions between the Debtors and prospective bidders.

The Sale Process Conducted by the Debtors Did Not Result in a Competitive Auction for the Debtors' Assets

4. As the Court is aware, between January 14 and January 17, 2019, the Debtors ostensibly conducted an auction of their assets. The stated purpose of the auction was to allow the Debtors to solicit bids for their assets, whether individually or collectively as a going concern, in an effort to effectuate an asset sale or sales that would yield the highest and best price and provide the greatest recovery to creditors.

5. There was only ever one party interested in making a going concern bid for substantially all of the Debtors' assets: ESL. There were, however, many parties interested in buying particular assets, and conceivably, if the Debtors had prepared for and conducted a robust and fair process, the sum of the various bids for individual assets and businesses could have exceeded ESL's going concern bid. Unfortunately, as described herein, no such process took place, and the so-called auction was nothing more than a bilateral negotiation between the Debtors and ESL regarding the terms of ESL's bid. No auction for individual assets ever took place. This was the direct result of a flawed sales process.

6. The origins of this non-competitive process began at the Debtors' filing. Upon filing, the Debtors were not at all prepared to conduct a sale process for the individual assets and operating businesses, and at no point during the bankruptcy process did the Debtors seriously engage in efforts to conduct a meaningful sale process. That, in turn, prevented interested third parties from effectively conducting due diligence on certain operating businesses and real estate

assets. This was reflected in the small number of bids and indications of interest received and the lowball nature of those bids.

7. Ultimately, the "auction" process itself was exclusionary and noncompetitive, amounting to only a one-horse race to transfer Sears and its valuable assets and operating businesses to ESL in exchange for consideration that allowed the Debtors to get closer to administrative solvency and without regard to the significant value of unencumbered assets or distributions to the Debtors' general unsecured creditors. At no time did the Debtors conduct a "sum of the parts" auction; the Debtors only compared successive ESL bids to hypothetical and conservative wind-down estimates. It is unsurprising that the result of such a flawed process is that the ESL bid fails to provide value for unencumbered assets and will plunge the estates into administrative insolvency.

a. The Debtors possess a number of highly-valuable unencumbered assets, but they are not simple to market

8. At the outset, it is critical to understand the scope of the unencumbered assets held by the Debtors that theoretically should have been part of the sales process and "auction." These assets include a diverse array of real properties as well as multiple unique, fully-functioning operating businesses. These assets are complex and are not something that can be marketed and sold overnight. Rather, considerable time and attention, meaningful advance planning, and specialized-treatment is required in order to truly maximize value of this diverse array of assets.

9. **Unencumbered Real Estate**. The Debtors possess a total of [redacted] unencumbered real estate assets. These real estate assets include: (i) Sears stores, (ii) Kmart stores, (iii) distribution centers, (iv) logistics facilities, (v) home services centers, (vi) Sears Auto Centers, (vii) office buildings, (viii) warehouses, and (ix) other miscellaneous properties. Certain of these properties are owned, others are leased, and others are subject to a ground lease. The Creditors'

Committees' real estate valuation expert, Mr. Greenspan, has estimated that the sale of this portfolio of properties would generate approximately [redacted] in a properly-conducted wind-down sales process.

10. **Sears Home Services**. The Debtors also own Sears Homes Services ("SHS"), a multi-faceted, stand-alone business. SHS is comprised of various sub-business lines including a home warranty business, an appliance repair business, a home improvement and remodeling service, a home improvement/maintenance business, and a business known as "Parts Direct" that sells parts for different household appliance brands. [redacted]

11. **Innovel**. The Debtors also own Innovel, an end-to-end logistics solutions provider. Innovel provides warehousing, transportation, installation and home delivery services to retail, manufacturing and commercial clients, making more than four million deliveries annually with 1,100 trucks on the road daily. Innovel is one of the largest warehousing and transportation networks in the country, capable of providing both last-mile and end-to-end services. [redacted]

12. **Monark**. The Debtors also own Monark Premium Appliance Company ("Monark"). Monark and its affiliates form a nationwide distributor of premium home appliances that serve architects, builders, designers, developers and homeowners. Monark's 20 showrooms across Arizona, California, Florida and Nevada offer customers a high-end selection of cooking, cooling and cleaning appliances from a variety of brands. [redacted]

13. **Other Assets**. The Debtors possess a variety of other unencumbered assets that should also have been subject to a robust sales process. This includes the customer data owned by the Debtors and Sears Auto Centers, among others.

b. Upon filing, the Debtors were not prepared to facilitate a robust and competitive auction process that leveraged interested parties against each other to maximize the value of the Debtors' assets

14. Even before the Debtors filed for bankruptcy, they understood that it was critical that the company provide financial information and diligence for specific operating businesses so that in a sale scenario a prospective buyer could, among other things, discern quality of earnings, determine how SG&A expenses were allocated, and assess the value of the marketed businesses and assets on a standalone basis, including under a scenario where the Debtors no longer conducted retail operations.

15. The Debtors knew in advance that this would be necessary to maximize value in any sale scenario of unencumbered assets. For instance, Centerview Partners had advised the Debtors in 2017 that bidders [redacted] during the 2016 sale process conducted by Citibank. The problem was that the Debtors had not made any progress towards trying to externalize that business.

16. Rather than heed this lesson, at the time they filed for bankruptcy, the Debtors appear to have done no advance planning whatsoever with respect to the marketing and sale of their unencumbered assets. Instead, the Debtors retained Lazard on the eve of filing and entered bankruptcy unprepared to run the type of sale process for their operating businesses that would allow third parties to perform the due diligence necessary to evaluate and finance these businesses on a standalone basis.

17. The Debtors' lack of planning is also evident in their approach to what should have been an extremely thoughtful and complex effort to maximize the value of their unencumbered

real estate. As discussed below and in the affidavit of Ron Greenspan of FTI, the Debtors did not order appraisals until after the filing, ran a confusing initial seven-day process over the holidays and did not even hire local corresponding brokers for most of their assets. The result was that only one entity understood the various unencumbered assets, including the real estate and the business lines, well enough to submit a bid on the timeline necessitated by these proceedings: ESL.

c. Non-ESL entities interested in bidding on any of the Debtors' operating businesses were not able to conduct necessary due diligence on those businesses

18. After entering into these bankruptcy proceedings, it was incumbent on the Debtors to do everything they could to run a robust sales process to realize the maximum possible value on their unencumbered assets. Unfortunately, the process run by the Debtors to market and solicit bids for their various unencumbered business lines – including SHS, Innovel, and Monark – was entirely inadequate. The Debtors failed to meaningfully engage with prospective bidders other than ESL, and as a result, non-ESL entities interested in bidding on the Debtors' operating businesses were unable to conduct the necessary due diligence to commit to a firm purchase of the complex assets for sale. In addition, the Debtors' myopic focus on a whole company ESL transaction, their short, shifting and unclear deadlines, and their lack of organized and clear information, all discouraged third parties from spending the significant time and resources necessary to commit to meaningful bids. Ultimately, these issues discouraged potential third-party bidders from participating in the sale process altogether.

19. Two examples come to mind of firms that did try to engage but were frustrated by the lack of engagement or information. The first is the interest of [redacted] in the "Parts Direct" business within SHS. [redacted] is a strategic buyer uniquely positioned to purchase the Parts Direct business notwithstanding the deficit in information provided by the Debtors. On October 17, 2018, [redacted] submitted a fully financed offer for [redacted] to be the stalking horse

bidder for the Parts Direct business, along with a marked-up asset purchase agreement and proposed bidding procedures, representing that they had very limited due diligence remaining before their bid could be committed. The Debtors failed to meaningfully engage with [redacted] and while the chapter 11 cases ran their course, [redacted] waited on the sideline. On December 5, 2018 [redacted] submitted a new stalking horse bid for Parts Direct, now [redacted], still fully financed. Again, the Debtors failed to keep [redacted] engaged or advance the state of negotiations, ultimately resulting in [redacted] submitting a new bid for Parts Direct of [redacted] on December 28, 2018. Partially owing to the Debtors' failure to quickly engage and commit, the bids Eldis submitted became progressively less attractive. [redacted] was never afforded the opportunity to actually bid at the auction despite repeatedly stating its desire and willingness to increase its price if there was more certainty and/or structure around the actual process being run.

20. Another notable failure by the Debtors to properly engage and follow-up with prospective buyers is highlighted in a January 8, 2019 email from [redacted] to me and my colleagues at Houlihan Lokey.[3] [redacted] was exploring transaction structures related to SHS (including the treatment of protection agreement liabilities), yet they could not obtain the due diligence they needed (and which *any* prospective buyer *would* require) from the Debtors regarding standalone general and administrative expenses associated with that business. According to [redacted] Lazard uploaded just three files to a data room on December 27, 2018, and have provided nothing regarding those assets since that date, resulting in [redacted] not having the information it needed to move forward.

[3] A true and correct copy of the referenced email is attached hereto as **Exhibit A**.

d. Entities interested in bidding on the Debtors' real estate assets were never provided a clear process and/or were not allowed to participate in the auction

21. The inadequate sales process the Debtors ran with respect to their business lines extended to their real estate assets as well.

22. Advisors to the Creditors Committee, despite frequent requests, were never apprised at any point of any meaningful marketing process undertaken by the Debtors with respect to their real estate assets, and have serious concerns that no such process ever took place. For example, on a December 12, 2018 call with Debtors' advisor Jones Lang LaSalle Incorporated ("JLL") just sixteen days before indicative bids were due, it was clear that the Debtors had not developed a marketing strategy or detailed insight into the sale process. And despite our repeated requests and receiving repeated assurances from the Debtors' advisors that marketing and progress reports (including tracking reports and lists of parties contacted) would be forthcoming, only one such report was ever actually provided.

23. The process run by the Debtors was flawed in four primary respects. First, the Debtors conducted the process on an extremely brief timeline that did not allow for sufficient time for prospective bidders to evaluate the Debtors' assets and submit bids. At the outset of the process, the Debtors only intended to market a small number of "non-core" properties for sale. None of the properties constituting the 425 "go-forward stores" were included. Subsequently, the Debtors pivoted to a process whereby they would market the entirety of their real estate assets. But because all indicative bids were due December 28, it was far too late to run a meaningful sales process. The solicitation process did not commence until December 2, 2018 when JLL first began its outreach through an "email blast," which alerted potential buyers of the opportunity to submit bids for the Debtors' real estate assets. Then, on December 21, 2018 – just a week before indicative bids were due – JLL launched official marketing websites and datarooms for the full set of Debtors'

real estate assets. The Debtors apparently expected potential bidders – most of whom are local and regional investors – to evaluate the opportunities available and to submit a bid within seven days, over the Christmas holidays, of receiving access to an inadequate dataroom. While the stated intention was for bids received to be part of the go-forward sale process, it is difficult to conceive how the timetable could permit bidders to engage in the necessary diligence and analysis to make an informed bid or was otherwise conducive to a successful auction for the Debtors' real estate.

24. Second, the process was disorganized and confusing to potential bidders. Given the abrupt change to the number of properties the Debtors were marketing, the tight timeframe, and the lack of communication with the market generally, there was considerable confusion over precisely which assets were actually for sale and which assets were subject to the December 28, 2018 deadline. Indeed, members of the Creditors' Committee informed Houlihan Lokey that they did not understand how to submit bids or even which properties were for sale. Overhanging the entire real estate process was the presence of ESL and the outcome of the Global Sale Process, which had its own competing deadlines and likely depressed bids due to the uncertainty of success. The fact that definitive bids for all of the Debtors' assets, including the real estate, were due on the same day as indicative real estate bids, created additional confusion. Potential real estate buyers have been highly critical of the lack of information and organization regarding the Debtors' auction, which is reflected in the quality and quantity of the bids received.

25. Third, the scope of the Debtors' outreach was deficient. It is my understanding, based on conversations between the Creditors' Committee's advisors and the Debtors' advisors that the Debtors never sought to market the properties broadly to any and all interested parties. Instead, I understand that the Debtors contacted only parties who had previously bid on the assets, and in the case of leased assets, certain landlords. This is reflected in a report provided to the

Committee by the Debtors' advisors on December 18, 2018, just ten days before the indicative bid deadline, which indicates that the Debtors had made only [redacted] points of contact in connection with the marketing and sale of [redacted] separate properties.[4] The Debtors' approach necessarily constrained the potential universe of bidders and resulted in fewer and lower bids.

26. Fourth, the Debtors failed to provide sufficient information to allow bidders the opportunity to develop a fully-formed view of the properties. At the time of its launch on December 21, 2018, the dataroom lacked basic information such as individual asset financials and marketing materials. Even as of January 8, 2019, eleven days after the deadline for indicative bids had passed, the dataroom was still being built and did not contain the customary real estate due diligence materials for each property, such as updated title policies with underlying assets, existing surveys, zoning reports, and environmental reports. While additional information was provided over time, that information came too late to make any meaningful difference in the bids received by the Debtors.

27. The result of these various deficiencies was that only a small number of potential bidders were aware of what the Debtors were selling, had limited information on which to base a decision to bid, and had very limited time to evaluate that information and decide whether and how much to bid. The sales process therefore attracted primarily opportunistic buyers who could submit low-ball offers with no cost or penalty, and incentivized stakeholders, including landlords, to submit placeholder bids as a means of expressing interest and opening a channel for negotiations. For example, the Debtors received [redacted] bids of either \$0 or \$1 for entire assets, and only around [redacted] bids were received for a total of [redacted] assets (excluding the [redacted] bids received for

4 [redacted]

all assets). Given all of the flaws with the Debtors' sale process, these bids are not a reliable indicators of the value of the properties.[5]

e. Unsurprisingly given the Debtors' sale process, ESL emerged as the winning bidder without a competitive auction ever taking place.

28. Instead of working to market their individual assets for sale to potential third party-bidders and working with bidders to maximize potential bids, the Debtors focused their efforts during this bankruptcy process almost entirely on negotiations with ESL to purchase substantially all the assets of the Debtors. This back-and-forth with ESL consumed the Debtors' attention during these bankruptcy proceedings to the detriment of any meaningful effort to pursue sales of individual assets in a value-maximizing process.

29. The efforts with ESL date back at least to December 5, 2018 when ESL submitted an indicative bid pursuant to the Global Bidding Procedures. The Debtors diligenced this bid and discussed it with ESL and its advisors, but ultimately determined that it was non-actionable, both legally and financially. Subsequently, on December 28, 2018, ESL submitted a revised "definitive bid" to acquire substantially all of the Debtors' go-forward retail footprint and other assets and component businesses of Sears (the "ESL Definitive Bid"). Following submission of the ESL Definitive Bid, the Debtors' advisors engaged with ESL and its advisors to discuss the infirmities of the bid, ultimately determining that this bid was also not actionable.

30. At this point, the Debtors indicated that they intended to pivot to a wind-down process. Instead, the Debtors resumed negotiations with ESL which, on January 9, 2019, submitted a revised bid attempting to remedy the deficiencies in its prior two bids. But as with ESL's prior bids, all parties, including the Debtors, agreed that this bid would have left the Debtors

[5] The Greenspan Declaration addresses additional shortcomings in the Debtors' real estate sales process.

administratively insolvent and provided no value to unsecured creditors. Nevertheless, the Debtors continued to engage in "around the clock" negotiation with ESL over the proposed bid.

31. These negotiations between the Debtors and ESL continued into the commencement of the so-called "auction" on January 14, 2019. As originally conceived, the auction was supposed to be a forum where various parties would compete to bid on many if not all of the Debtors' valuable assets. But the actual auction turned out to be little more than a venue for the Debtors' continued bilateral negotiations with ESL. Interested bidders in real estate assets who arrived at the auction on the first day were initially turned away by the Debtors. While the Debtors continued to negotiate exclusively with ESL, third parties who wished to bid for discrete assets literally wandered the offices of Debtors' legal counsel confused as to whether they would even get a chance to bid in an auction.

32. It is no exaggeration to state that no actual auction ever took place. Instead, over the course of several days and nights, negotiations between the Debtors and ESL played out. After additional back-and-forth between the Debtors and ESL over the first day and a half of the auction, the Debtors continued to reject ESL's bid, admitting that the bid left the Debtors administratively insolvent and [redacted] short of even getting to closing. Counsel to the Restructuring Subcommittee agreed that the bid did not provide sufficient cash to close the transaction and would leave the Debtors administratively insolvent. Then ESL presented yet another offer. Although this new bid – the infirmities of which are discussed in detail in the attached slide deck – failed to remedy the fundamental problems with prior bids, the Debtors nevertheless accepted the bid (the "ESL Bid") and declared ESL the "Successful Bidder" in the early morning hours of January 17, 2019.

33. The Debtors have explained to me that the primary driver of their decision to accept this ESL Bid when they had just rejected a substantially similar bid hours earlier was that the new ESL Bid included an agreement by [redacted] to acquire and subsequently roll over the entire outstanding Junior DIP. In the Debtors' view, [redacted] agreement remedied an existing $120 million shortfall, thereby bringing the Debtors sufficiently close to administrative solvency to justify proceeding with the ESL Bid. In my view, this argument is a red herring because no actual value was generated for the estate by [redacted] acquiring and rolling the outstanding Junior DIP. The entirety of this new $120 million in value is allocated to paying the expenses associated with continuing to pursue the ESL Bid, meaning that it generated no more value to the Debtors' estate than if the Debtors had simply rejected the ESL Bid and pivoted to an orderly wind-down. This is evidenced by the Debtors' analysis of an orderly wind-down scenario, which projects only [redacted] of draws on the Junior DIP versus $350 million required to be drawn to fund the closing of the ESL Bid. Put differently, only ESL benefited from this $120 million change by being able to prevail in the bidding process, while the Debtors themselves were no better off than if they had rejected the "improved" bid outright.

34. Although it took several days of "around the clock" negotiations for the Debtors and ESL to strike their deal, the ultimate outcome was preordained. The Debtors never seriously pursued or entertained any alternative to ESL. Their focus during the 90 days between filing and the auction was on getting a deal with ESL to "save" the company. Because they expended no meaningful effort on an orderly liquidation sales process, the ultimate result – a deal with ESL – was essentially a fait accompli.

ESL's Bid Is Inadequate

35. In the slide deck attached hereto as **Exhibit B**, I explain in detail why the final ESL Bid is inadequate and inferior to an organized wind-down of the Debtors' retail operations and sale of its other operating businesses and real estate in an organized process (the "Alternative Sale Process"), even according to the Debtors' own analysis. Unlike the ESL Bid, the Alternative Sale Process provides value to unencumbered assets. Moreover, unlike the ESL Bid, which renders the Debtors administratively insolvent, the Alternative Sale Process ensures administrative solvency. As such, it is superior to the ESL Bid, and the ESL bid should be rejected.

Conclusion

36. Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge.

New York, New York
January 26, 2019

By:

Saul E. Burian
Managing Director
Houlihan Lokey Capital, Inc.

EXHIBIT A

[redacted]
Subject: Fwd: Sears
Date: Tuesday, January 8, 2019 4:28:08 PM

[redacted]

Begin forwarded message:

[redacted]
Date: January 8, 2019 at 4:20:37 PM EST
[redacted]
Subject: RE: Sears

You can look at the data room yourself. They uploaded three files on 12/27/18 and nothing since.

[redacted]

[redacted]
Sent: Tuesday, January 8, 2019 3:32 PM
[redacted]
Subject: Sears

[Warning: External]

Spoke to Lazard, after you did. Sounds like they think they provided a significant amount of the diligence and are willing to organize a call for tomorrow to figure out the rest. We will be on

[redacted]

[redacted]

[redacted]

Please consider the environment before printing.

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EXHIBIT B

HOULIHAN LOKEY

In re: Sears Holdings Corporation et al.

ANALYSIS OF ESL BID AND DEBTORS' ALTERNATIVE SALE PROCESS

JANUARY 26, 2019 | CONFIDENTIAL

Table of Contents

Introduction and Limiting Factors

- This analysis has been prepared by Saul E. Burian, Managing Director at Houlihan Lokey Capital, Inc. (“HL”) in connection with the objection of the Official Committee of Unsecured Creditors (the “Committee” or the “UCC”) to the sale of the assets of Sears Holdings Corporation (“Sears,” and collectively with its debtor-affiliates, the “Debtors” or the “Company”) before the Bankruptcy Court for the Southern District of New York
- In preparing this analysis, I have assumed and relied on the accuracy and completeness of all financial and other information furnished to me by the Company and other third parties, as well as publicly-available information, unless otherwise stated herein. I have not prepared an enterprise valuation analysis in connection with this report
- As and to the extent that the Committee receives additional information from the Debtors, or additional or different facts and circumstances become known to the Committee, I reserve the right to supplement the analysis and conclusions included in this analysis but am under no obligation to do so

Scenarios Considered

The Debtors purported to conduct an auction starting on January 14th, 2019 (the "Auction"). In fact, the Debtors only seriously considered the ESL Investments, Inc. ("ESL") "going concern" bid (the "ESL Bid"). The ESL Bid was then compared to the Debtors' estimated proceeds from an orderly sale of the Debtors' assets (the "Alternative Sale Process")

- Set forth in the following materials is an analysis of:

1) **ESL Bid** – the bid ultimately accepted by the Debtors at the Auction as described in the Asset Purchase Agreement filed as ECF No. 1730 by the Debtors on January 18, 2019

2) **Alternative Sale Process** – the recovery analysis in an orderly sale of assets as set forth by the Debtors in connection with the Auction

3) **Adjusted Alternative Sale Process** – the Alternative Sale Process as adjusted to account for:

   a) administrative expenses and priority claim allocation;

   b) allowable claims and claim amounts; and

   c) asset value assumptions

Primary Observations

1) **Administrative Solvency**: By the Debtors' own admission, the ESL Bid leaves the estates administratively insolvent (see the Diaz Declaration). However, under the Debtors' analysis of the Alternative Sale Process all administrative and priority claims are shown to be paid in full

2) **Unsecured Creditor Recoveries**: As shown in the Adjusted Alternative Sale Process analysis, an orderly sale of the Debtors' assets should yield significant recoveries to unsecured creditors, while the ESL Bid arrogates to insiders all of the estates' unencumbered asset value

3) **Selection of ESL Bid**: The net difference between ESL's bid that the Debtors rejected midway through the "Auction" and the version ultimately accepted can be summarized in the following items:

   i. The assumption of $120mm of additional Junior DIP, which is incurred solely to bridge to close the ESL Bid; and

   ii. The limitation of the preserved adequate protection claims that the UCC does not believe are enforceable

4) **Debtors' Methodology**: The Debtors justified acceptance of a bid that provides no value to unsecured creditors by inexplicably modifying the following two winddown assumptions:

   i. The allocation of administrative expenses among the secured and unsecured claims; and

   ii. The amount and enforceability of second lien adequate protection claims

ESL Bid vs. Alternative Sale Process

Set forth below is a comparative analysis of recoveries to various stakeholders under the ESL Bid (assuming underlying closing conditions are satisfied), the Alternative Sale Process (as detailed by the Debtors at the Auction), and the Adjusted Alternative Sale Process

[redacted]

ESL Assumptions Necessary to Close

Set forth below are certain conditions and assumptions that must be met for the ESL Bid to close

1) **ESL must purchase or otherwise satisfy certain secured claims which it currently does not own**
   - The ESL Bid contemplates the credit bid of the entire $125mm Prepetition FILO
     - ESL currently owns $70mm and therefore needs to purchase $55mm
   - ESL owns the entire $723mm junior tranche of the Dove Facility (and contemplates credit bidding $544mm of that loan), and ESL must purchase the $108mm senior tranche of the Dove Facility, currently owned by Cascade, in order to close
2) **The Debtors must "manage down" the projected ABL DIP balance of [redacted] by closing, without increasing administrative claims or decreasing ABL Collateral**
   - The ESL Bid has a maximum New ABL commitment of $850mm
3) **The deal is premised on ESL's ability to acquire / license the Kenmore and DieHard brands from non-debtor KCD IP, LLC**

(1) Figure is as of the latest available information at the Auction. We understand the Debtors have since updated this figure, however we have not yet been able to diligence the revised figure

ESL Bid – Consideration Analysis

Set forth below is a summary of the "value" of the ESL Bid as indicated by ESL and the adjusted value of the bid based upon the Debtors' estimates of underlying collateral values supporting the ESL debt

ESL Bid Consideration Analysis

($ in millions)	
Cash from New ABL ($1.3 billion total facility)	[redacted]
Dove Credit Bid	
IP / GL Credit Bid - ESL & [redacted]	
FILO Credit Bid - ESL & [redacted]	
FILO Credit Bid - Non-ESL & [redacted]	
Second Lien Credit Bid	
Total Credit Bid	
LC Facility Roll-Over - ESL & [redacted]	
Junior DIP Roll-Over(1)	
Total Roll-Over	
Assumption of Sparrow Liability	
Assumption of PA Liability(2)	
Assumption of SYW Points and Gift Card	
Total Assumption of Non-Administrative Liabilities	
503(b)(9)	
Postpetition Accounts Payable (Merchandise and Non-Merchandise)	
Severance and WARN	
Employee Claims	
Property Taxes	
Cure Costs	
Total Assumed Administrative Claims	
Cash for ESL Release(3)	
Cash for Store Register Cash	
Total Bid Consideration	

[redacted]

ESL Bid Rejected vs. “Winning” ESL Bid

Set forth below is a comparison of the version of ESL’s bid that was expressly rejected by the Debtors (and the restructuring subcommittee) and the ESL Bid that was ultimately accepted hours later

Comparison of Administrative Claims Shortfall

[redacted]

Debtors' Alternative Sale Process

Recovery Matrix

[redacted]

Debtors' Alternative Sale Process

Adjustments to Methodology, Claims and Assets

Set forth below is a summary of adjustments that should be made to the Debtors' Alternative Sale Process analysis so that it can be properly compared to the ESL Bid

[redacted]

1 Debtors’ Alternative Sale Process

Debtors’ Change to Analysis

Set forth below is a comparison of the waterfall analyses the Debtors presented on December 13, 2018 and January 14, 2019. [redacted]

[redacted]

1 Debtors’ Alternative Sale Process

Debtors’ Allocation of Administrative Claims (New Method)

Shortly before the Auction, the Debtors dramatically changed their method of allocating administrative claims in the Alternative Sale Process

[redacted]

1 Debtors' Alternative Sale Process

Debtors' Allocation of Administrative Claims (Old Method)

Set forth below is the Debtors' prior method of allocating administrative claims in the Alternative Sale Process

[redacted]

1 Debtors’ Alternative Sale Process

Adjustments to Administrative Claim Allocation Methodology

Set forth below is a corrected allocation method for allocating administrative and priority expenses

[redacted]

Adjusted Alternative Sale Process

Set forth below is a summary of the Adjusted Alternative Sale Process with adjustments to: [redacted]

Adjusted Alternative Sale Process

Equitable Subordination / Recharacterization Considerations

Set forth below is a table illustrating the impact on unsecured recoveries based on different ESL equitable subordination / recharacterization outcomes

[redacted]

Administrative and Priority Claim Allocation Methodology Support

[redacted]

[redacted]

CORPORATE FINANCE
FINANCIAL ADVISORY SERVICES
FINANCIAL RESTRUCTURING
STRATEGIC CONSULTING

HL.com

HOULIHAN LOKEY

Exhibit B

Diaz Declaration

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
SEARS HOLDINGS CORPORATION, *et al.*,	:	Case No. 18-23538 (RDD)
Debtors.[1]	:	(Jointly Administered)

DECLARATION OF MATTHEW DIAZ IN SUPPORT OF THE OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS TO ESL INVESTMENTS, INC.

January 26, 2019

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are as follows: Sears Holdings Corporation (0798); Kmart Holding Corporation (3116); Kmart Operations LLC (6546); Sears Operations LLC (4331); Sears, Roebuck and Co. (0680); ServiceLive Inc. (6774); SHC Licensed Business LLC (3718); A&E Factory Service, LLC (6695); A&E Home Delivery, LLC (0205); A&E Lawn & Garden, LLC (5028); A&E Signature Service, LLC (0204); FBA Holdings Inc. (6537); Innovel Solutions, Inc. (7180); Kmart Corporation (9500); MaxServ, Inc. (7626); Private Brands, Ltd. (4022); Sears Development Co. (6028); Sears Holdings Management Corporation (2148); Sears Home & Business Franchises, Inc. (6742); Sears Home Improvement Products, Inc. (8591); Sears Insurance Services, L.L.C. (7182); Sears Procurement Services, Inc. (2859); Sears Protection Company (1250); Sears Protection Company (PR) Inc.(4861); Sears Roebuck Acceptance Corp. (0535); Sears, Roebuck de Puerto Rico, Inc. (3626); SYW Relay LLC (1870); Wally Labs LLC (None); SHC Promotions LLC (9626); Big Beaver of Florida Development, LLC (None); California Builder Appliances, Inc. (6327); Florida Builder Appliances, Inc. (9133); KBL Holding Inc. (1295); KLC, Inc. (0839); Kmart of Michigan, Inc. (1696); Kmart of Washington LLC (8898); Kmart Stores of Illinois LLC (8897); Kmart Stores of Texas LLC (8915); MyGofer LLC (5531); Sears Brands Business Unit Corporation (4658); Sears Holdings Publishing Company, LLC. (5554); Sears Protection Company (Florida), L.L.C. (4239); SHC Desert Springs, LLC (None); SOE, Inc. (9616); StarWest, LLC (5379); STI Merchandising, Inc. (0188); Troy Coolidge No. 13, LLC (None); BlueLight.com, Inc. (7034); Sears Brands, L.L.C. (4664); Sears Buying Services, Inc. (6533); Kmart.com LLC (9022); and Sears Brands Management Corporation (5365). The location of the Debtors' corporate headquarters is 3333 Beverly Road, Hoffman Estates, Illinois 60179.

1. I am a Senior Managing Director at FTI Consulting, Inc. ("FTI"), a leading, NYSE-listed international financial advisory firm. I have been providing financial advisory services to companies and creditor groups undergoing in-court and out-of-court restructurings in a variety of industries for over 15 years. In the course of my professional experience, I have had the occasion to review and assess many business plans, wind down plans, claims analyses, asset purchase agreements, and related sales documents. I have also advised trusts formed pursuant to Chapter 11 plans whereby I reviewed administrative and priority claims.

2. FTI was retained as the financial advisor to the Unsecured Creditors' Committee (the "Committee") of Sears Holdings Corporation and its affiliated debtors and debtors in possession (collectively, the "Debtors") effective October 25, 2018.

3. Among the services being provided by FTI to the Committee are the following: (i) assist in the review of the Debtors' claims reconciliation and estimation process, including assessment of priority level; (ii) conduct due diligence regarding, and provide advice with respect to, the Debtors' projected cash flow, liquidity and operating results; (iii) review and evaluate the Debtors' business plan and go-forward business strategies; and (iv) assist in the review and/or preparation of information and analysis necessary for the confirmation of a plan and related disclosure statement in these chapter 11 cases.

4. As a part of FTI's engagement, I have overseen various workstreams during the Debtors' bankruptcy process, including, but not limited to, assessing the impact of the Debtors' proposed sale to ESL Investments ("ESL") and the resulting wind down of the Debtors' estates.

I. The ESL Sale Will Render the Debtors' Estates Administratively Insolvent

5. The Debtors have consistently and repeatedly stated the importance of keeping their estates administratively solvent, given the Debtors' precarious financial position.

Nevertheless, the Debtors agreed to accept an ESL bid, which by their own calculations, renders the Debtors' estates administratively insolvent.

a. The Debtors established a Wind-Down Reserve account to satisfy administrative claims

6. On October 15, 2018, concurrent with the bankruptcy petition, the Debtors filed a motion for post-petition Debtor-In-Possession ("DIP") financing. Pursuant to this motion, the Debtors were required to set up a reserve account funded by the first $200 million of proceeds from the sale of unencumbered assets. This reserve account was to be used to fund wind-down costs (the "Wind-Down Reserve"). During the first day motion hearings, the Debtors' legal counsel made the following statement to the Court:

> [A] very important and, frankly, hard-fought negotiated point is that the first $200 million of proceeds that come from unencumbered asset sales are going to be put in a winddown reserve account. That winddown reserve account is there for the estate that if they sell their assets, if they have an estate that needs to be administered, they're really there to make sure that the company has sufficient funds to always wind down the estate and importantly pay severance, pay other administrative claims of the company.[2]

7. On November 27, 2018, at the DIP hearing, and in connection with the Committee's objections, the Wind-Down Reserve balance requirement was increased to $240 million (from $200 million) and subsequently entered into the final DIP order.[3]

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[2] ECF No. 136, *Tr. regarding Hearing Held on Oct. 15, 2018 at 2:13 PM regarding Notice of Hearing/ Notice of Commencement of Chapter 11 Cases and Agenda for First Day Hearing; Motion of Debtors for Entry of Order Directing Joint Administration of Related Chapter 11 Cases filed by Ray C Schrock on behalf of Sears Holdings Corporation; Debtors Motion for Authority to (A) Obtain Postpetition Financing, (B) Use Cash Collateral, (C) Grant Certain Protections to Prepetition Secured Parties, and (D) Schedule Second Interim Hearing and Final Hearing*.

[3] ECF No. 952, *Final order (i) authorizing the debtors to (a) obtain post-petition financing, (b) grant senior secured priming liens and superpriority administrative expense claims, and (c) utilize cash collateral; (ii) granting adequate protection to the prepetition secured parties; (iii) modifying the automatic stay; and (iv) granting related relief*, ¶23 (Nov. 30, 2018).

b. Ensuring administrative solvency was a key point of negotiation between the Debtors and ESL

8. On December 28, 2018, the Debtors received a bid from ESL for a going concern sale of substantially all of their assets that would have rendered the Debtors substantially administratively insolvent.[4] Since then, the Debtors have engaged in numerous discussions and negotiations with ESL concerning a shortfall of required administrative claims.

9. On January 6, 2019, in a presentation prepared by the Debtors' advisors, Lazard and M-III Partners, the Debtors summarized the administrative and priority claims that will need to be satisfied in the event of a going concern sale, and identified a total gross administrative claims shortfall of [redacted]. After taking into account the assets not subject to the sale, the net administrative claims shortfall was [redacted]. The Debtors requested that ESL back-stop this net shortfall.[5]

10. On January 7, 2019, ESL updated its terms to assume [redacted] of liabilities not included in its original bid that would essentially reduce the administrative claims shortfall from [redacted] to [redacted].[6]

11. Between January 7, 2019, and the start of the Section 363 "auction" on January 14, 2019, the Debtors continued to refine their numbers and determined that the administrative claims shortfall had grown from [redacted] to [redacted], or to [redacted] if one were to include [redacted] million of accrued post-petition royalties ("IP Royalty Payments") related to intellectual property licensing fees owed to KCD IP LLC ("KCD"), a non-debtor entity.[7,8]

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[4] Letter from Transform Holdco LLC c/o ESL Investments, Inc. to Lazard Frères & Co. LLC dated December 28, 2018, regarding definitive bid to acquire substantially all assets of the Debtors.

[5] "Discussion Materials – Project Blue," prepared by Lazard and M-III Partners, on behalf of the Debtors, dated January 6, 2019.

[6] "Project Transform – ESL Bid Proposal," prepared by ESL Investments, dated January 7, 2019.

[7] *Id.*

c. During the auction process the Debtors' counsel repeatedly asserted that the ESL bid was deficient and left the estate administratively insolvent

12. On January 14 and 15, 2019, during the sale proceedings, counsel for both the Debtors and the Restructuring Subcommittee reiterated that the ESL bid did not cover the administrative claims shortfall and would render the estate administratively insolvent.

13. On January 15, 2019, counsel for ESL stated "Over the past few weeks, the Debtors have been singularly focused on one thing, which is requiring ESL to guarantee that the debtors will not become administratively insolvent."[9]

14. Later, counsel for the Debtors stated in regard to the status of the ESL bid that "At this time, unfortunately, after consulting with the consultation parties, the restructuring committee has determined that the ESL bid is not executable and is not otherwise higher or better when compared to the company's alternatives."[10]

15. Counsel for the Debtors continued, highlighting one of the many shortfalls of ESL's bid that would lead to administrative insolvency:

> When we looked at the consideration that was being provided for unencumbered assets . . . most of those assets were being purchased by ESL for relatively little consideration . . . But when you couple that with having a party that's buying basically all of the assets and we are left in [an] administratively insolvent position, *we believe that there was insufficient consideration for the unencumbered assets*.[11]

16. Counsel for the Restructuring Subcommittee also highlighted the deficiencies in ESL's bid:

> The subcommittee proposed that ESL could credit bid, receive a release of equitable subordination and recharacterization claims if it proposed a better

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[8] "Discussion Materials – Project Blue," prepared by Lazard and M-III Partners, on behalf of the Debtors, dated January 14, 2019.

[9] Auction Proceedings transcript dated January 15, 2019, received from the United States Bankruptcy Court Southern District of New York, reported by Mary F. Bowman, (Job No. 154062).

[10] *Id.*

[11] *Id* (emphasis added).

> transaction. And a better transaction is a transaction that can close, that would not leave the company administratively insolvent, that would provide a better recovery for creditors other than ESL, and that has provided some direct consideration for the opportunity to credit bid and release the equitable subordination and recharacterization claims . . . *Unfortunately, the proposed ESL transaction meets none of the legal requirements and primarily benefits ESL.*[12]

17. Counsel for the Restructuring Subcommittee concluded that "Administrative solvency is a commitment by the company to pay back those parties that provide goods and services to the estate post-petition, so it can conduct a reorganization and get to the other side. ESL's bid leaves the company admittedly administratively insolvent."[13]

18. Despite this, at 2:20 in the morning, on January 16, 2019, the Debtors and the Restructuring Subcommittee accepted ESL's bid, even though their own calculations showed it would leave the Debtors administratively insolvent, as discussed below.

II. <u>The Debtors' Estimate of Administrative Claims Shortfall is Understated</u>

19. As set forth in the table below, at the time of the auction, the Debtors estimated that there would be an administrative claims shortfall of [redacted], and the Committee estimated that there could be an administrative claims shortfall of as much as $226 million,[14] as a result of accepting the ESL bid.

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[12] *Id* (emphasis added).

[13] Auction Proceedings transcript dated January 15, 2019, received from the United States Bankruptcy Court Southern District of New York, reported by Mary F. Bowman, (Job No. 154062).

[14] I understand that the indenture trustee for the KCD Notes has asserted that royalty payments obligations are due and owing. While the Committee continues to evaluate the propriety of such assertion, the Debtors chose to ignore the assertion of such payment obligations.

$ in millions	**Debtors' Estimate**	**Committee's Estimate**
Administrative Obligations Not Assumed by ESL		
503(b)(9)	[redacted]	[redacted]
Accounts Payable	[redacted]	[redacted]
Taxes and Other	[redacted]	[redacted]
RemainCo Winddown Costs	[redacted]	[redacted]
ABL DIP	[redacted]	[redacted]
Total Administrative Claims	[redacted]	**$290**
Sources of Value Left Behind by the Debtors' Estate		
Less: MTN Sale Proceeds	(81)	(81)
Less: Cash at Banks	[redacted]	[redacted]
Less: Store Cash	[redacted]	[redacted]
Less: Other Cash - Utility Deposit	[redacted]	-
Less: Insurance Proceeds	[redacted]	[redacted]
Less: SHIP Sale Deposit	(6)	(6)
Less: UHAUL Unencumbered Proceeds	(7)	(7)
Potential Additional Post-Petition Obligations		
Add: KCD Royalties	-	[redacted]
Total Potential Administrative Claims Shortfall As Of the Time of the Auction	[redacted]	**$226**

20. The table above identifies three differences between the Debtors' and the Committee's estimates of the claims shortfall as of the time of the auction.

21. First, the Debtors understood that there would be a shortfall because the proposed Asset Purchase Agreement ("APA") limited the amount of the ABL DIP outstanding at close to $850 million.[15,16] Rather than include the amount actually expected to be outstanding at close on the ABL DIP based on then-current projected cash flows, the Debtors estimated that [redacted] would be outstanding on the ABL DIP—a [redacted] shortfall. In fact, the Debtors' cash flow budget at the time of the auction, which contained *actual* cash flow results through

[15] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[16] "Transform Transaction – Weekly Tracking" dated January 23, 2019, prepared by the Debtors.

January 5, 2019 ("Debtors' Auction Cash Flow Budget"), projected the ABL DIP balance to be [redacted] as of the anticipated sale closing date of February 9, 2019.[17] Thus, the actual amount of the projected shortfall was [redacted], not [redacted], meaning there was an unaccounted for [redacted] delta in the Debtors' shortfall estimate. Accordingly, the Committee used the [redacted] ABL DIP balance to calculate its estimate, consistent with the Debtors' cash flow projections.

22. Second, at the time of the auction, the Debtors assumed that they would retain [redacted] of proceeds from utility deposits. However, section 2.1(o) of the ESL APA concerning the acquired assets states that ESL, not the Debtors, would retain any such security deposits.[18,19] Therefore, the Committee has excluded the utility deposit from its estimate of administrative claims shortfall.

23. Third, the Debtors may owe [redacted] of IP Royalty Payments to KCD at closing.[20] These royalties are associated with the Debtors' sale of products with intellectual property owned by KCD. The Debtors have not paid these royalties since the petition date. For illustrative purposes, the Committee has included this amount in its estimate.

---

[17] "Project Blue Revised Cash Flow Budget – Going Concern" dated January 11, 2019 prepared by the Debtors.

[18] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[19] SEARS-UCC00282037; "Discussion Materials – Project Blue," prepared by Lazard and M-III Partners, dated January 16, 2019.

[20] "Discussion Materials – Project Blue", prepared by Lazard and M-III Partners, on behalf of the Debtors, dated January 14, 2019.

a. At the time of the auction, the Debtors' advisors tried to justify their decision to accept the ESL bid by citing certain potential "upsides" that could cover the administrative claims shortfall

24. Based on my discussions with the Debtors' advisors at the auction, I understood that there were certain sources of value they hoped would mitigate the projected administrative claims shortfall. Since that time, Debtors have attempted to quantify the potential upsides, as discussed below.[21]

25. Inventory Not Being Sold to ESL: In early January, the Debtors initiated going out of business sales at eighty of its stores (the "Wave 3 GOB Sales"). The inventory associated with the Wave 3 GOB Sales is considered an excluded asset under section 2.2(d) of the ESL APA.[22] The Debtors estimate and include [redacted] of proceeds associated with the Wave 3 GOB Sales after the proposed closing of the sale to ESL.

26. Value from Credit Bid Release Consideration Reserve: The ESL purchase price will include a $35 million cash reserve for release and discharge of certain claims.[23]

27. Value of Excess Inventory and Receivables: Pursuant to section 10.9 of the APA, if the aggregate amount of the inventory, credit card receivables and pharmacy receivables (together, the "New ABL Collateral") acquired by ESL as of the closing date exceeds $1.657 billion, the Debtors, at their own expense, can have the aggregate amount in excess of the $1.657 billion transferred, primarily in the form of inventory, to the GOB stores and retain the proceeds.[24] The Debtors' estimate of New ABL Collateral as of January 23, 2019 indicates a

[21] "Transform Transaction – Weekly Tracking" dated January 23, 2019, prepared by the Debtors.

[22] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[23] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[24] *Id.*

projected shortfall of [redacted].[25] The $1.657 billion of required New ABL Collateral is a condition precedent to close. It is unclear what will happen if the New ABL Collateral is insufficient at closing. Separately, the Debtors have identified [redacted] of excess inventory that is presumably not New ABL Collateral that could be a source of value to reduce the administrative shortfall. It is not clear if the Debtors will be able to liquidate this excess inventory, and even if liquidation is possible, the price obtainable for the inventory remains uncertain.[26]

28. Reduced Accounts Payable: The Debtors estimate that there may be opportunities to reduce up to [redacted] of projected accounts payables as a result of managing disputed payables, reducing non-essential spend, and potentially recovering prepetition cash deposits.[27,28] The actual amount and likelihood of these mitigating factors is subject to significant uncertainty.

29. Historical Favorable Budget to Actual Variance: The Debtors hope that their cash flow budget is conservative and cite past favorability to their budgets as a potential additional source of cash. As of the week ending January 19, 2019, the Debtors' rolling four-week net cash flow was $[redacted] favorable to budget.[29] The Debtors hope that these trends continue and recently lowered their projected February 9, 2019 DIP ABL balance from [redacted] in the Debtors' most recent cash flow budget, which shows actual results through January 19, 2019 ("Debtors' Cash Flow Budget").[30,31] Additionally, the Debtors have identified up to [redacted] of additional opportunities to reduce its ABL DIP balance from various

[25] "Transform Transaction – Weekly Tracking" dated January 23, 2019, prepared by the Debtors.
[26] *Id.*
[27] *Id.*
[28] SEARS-UCC00282037; "Discussion Materials – Project Blue," prepared by Lazard and M-III Partners, dated January 16, 2019.
[29] "Project Blue Weekly Flash Report (DIP Budget Week 14)" dated January 23, 2019 prepared by the Debtors.
[30] "Project Blue Revised Cash Flow Budget – Going Concern" dated January 11, 2019 prepared by the Debtors.
[31] "Project Blue Rolling Cash Flow Budget (Week 14)" dated January 23, 2019 prepared by the Debtors.

receipts and operational proceeds.[32] The actual amount and the likelihood of receiving these additional funds is subject to significant uncertainty.

b. The Debtors' assessment, however, was one-sided and considered potential "upsides" and essentially ignores the numerous "downsides" to the Debtors' liquidity picture that would increase the Debtors' estimated administrative claims shortfall

30. The Debtors' advisors failed to adequately assess the risk that numerous potential downsides would materialize and would increase the degree to which they will be administratively insolvent.

31. Accrued Payroll Due at Closing: ESL will assume the liability of payroll obligations of the employees beginning on the anticipated sale closing date of February 9, 2019 per sections 2.4(f) and 9.7(b) of the APA.[33] The Debtors will be liable to pay all accrued but unpaid payroll obligations until the sale closing date. Most of the Debtors' employees are paid in alternating staggered biweekly cycles every other Friday. Approximately 12% of the Debtors' employees are paid on a semi-monthly basis: on the 15th and the last day of each month.[34] The Debtors have not included accrued payroll in their administrative claims estimates. Based on the Debtors' Cash Flow Budget, approximately [redacted] in payroll, taxes and benefits are estimated to be paid out during the week of February 16, 2019, which is a conservative indication of the amount of payroll obligations that would have been accrued as of the previous week (the week ending February 9).[35]

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[32] "Transform Transaction – Weekly Tracking" dated January 23, 2019, prepared by the Debtors.

[33] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[34] ECF No. 31, *Motion of the Debtors for entry of order (i) authorizing the Debtors to(a) pay certain prepetition wages and reimbursable employee expenses, (b) pay and honor employee medical and other benefits, and (c) continue employee benefits programs, and (ii) granting related relief* (Oct. 15, 2018).

[35] "Project Blue Rolling Cash Flow Budget (Week 14)" dated January 23, 2019 prepared by the Debtors.

32. Warranties and Protection Agreements Liabilities: Pursuant to section 2.3(e) and section 2.8(e) of the APA, ESL will not assume the warranty and protection agreement liabilities from the Debtors until the KCD Notes—which are debt obligations between KCD and Sears Reinsurance Company Ltd. ("Sears Re")—are transferred to ESL. The transfer of the KCD Notes require consent from the applicable Bermuda regulatory authority.[36] The timing of this transfer is uncertain. Until the KCD Notes get transferred, ESL will service the warranty claims and protection agreements, and the Debtors will reimburse ESL for the associated costs.[37] The Debtors' cost of servicing under the warranties and protection agreements is approximately [redacted] a month, an amount Sears Re was supposed to reimburse. Since the petition date, Sears Re has stopped reimbursing the Debtors. It is uncertain how the Debtors will reimburse ESL for the warranty and protection agreement liabilities without reimbursement from Sears Re. These claims have not been considered in the Debtors' estimate of administrative liabilities and will increase the administrative claims shortfall by an estimated [redacted] per month. For illustrative purposes, it is assumed that the Debtors will incur costs of at least $30 million, or one month.

33. Loss of Cash at Banks: The Debtors estimate that [redacted] of cash at banks will remain in their estates. The Debtors' most recent administrative claims analysis acknowledges the risk of recovering all of this cash and assigns a [redacted] risk weighting on the proceeds."[38] If the cash is not collected, the Debtors' administrative claims shortfall would increase by roughly [redacted].

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[36] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[37] *Id.*

[38] SEARS-UCC00282037; "Discussion Materials – Project Blue," prepared by Lazard and M-III Partners, dated January 16, 2019

34. Loss of the SHIP Deposit: The Debtors currently assume that they will retain the $6 million deposit received from Service.com in connection with the SHIP purchase agreement. However, section 2.1(z) and section 2.2(p) of the ESL APA concerning the acquired assets and excluded assets, respectively, state that the Debtors will retain this deposit only if the SHIP purchase agreement terminates prior to ESL closing. If the SHIP purchase agreement terminates after the closing, then the SHIP assets will be included in the ESL sale, and all proceeds including the deposit from the SHIP sale will be retained by ESL. The Creditors' Committee understands, however, that Service.com may contest the Debtors' termination of the SHIP Purchase Agreement, and the Debtors' entitlement to retain the $6 million deposit. If the Debtors are not permitted to retain the $6 million deposit, there would be a dollar of dollar increase in the Debtors' administrative insolvency.

35. Mechanic's Lien Obligations: There are approximately $4 million of mechanic's liens that have been alleged or asserted against the Debtors' estates. During the auction proceedings, ESL's counsel stated that "NewCo [was] to assume 4 million dollars in mechanic's liens."[39] However, in the executed APA, ESL has not agreed to assume these mechanic's liens and considers them as excluded assets under section 2.4(r).[40] If not resolved, these liens will further increase the administrative claims of the Debtors.[41]

36. Cost of Closing Delays: A delay in closing the sale to ESL from February 9, 2019, will cause the Debtors to incur substantial costs. First, there is significant uncertainty to ESL's ability to timely close the transaction, including ESL's ability to demonstrate adequate assurance to counterparties associated with assumed leases and contracts. Second, the Debtors'

[39] Auction Proceedings transcript dated January 15, 2019, received from the United Stated Bankruptcy Court Southern District of New York, reported by Mary F. Bowman, (Job No. 154062).

[40] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[41] *Id.*

Cash Flow Budget shows the DIP ABL balance growing from [redacted] due to a one-week delay, and exceeds [redacted] with further delays.[42] Third, if the ESL sale does not close by February 9, 2019, the additional cash burn impacting the Debtors' estates is estimated to be [redacted] per day based on the Debtors' own estimates, which were stated during the sale hearing on January 8, 2019.

37. Unfavorable Budget to Actual Variances: The Debtors' Auction Cash Flow Budget projects the ABL DIP balance to be [redacted] as of the anticipated closing date of February 9, 2019.[43] If there are any unfavorable variances to this budget, it would reduce projected liquidity.

38. Unfavorable 503(b)(9) Claims: The Debtors' actual 503(b)(9) costs could be larger than the [redacted] identified by the Debtors' administrative claims schedule, of which ESL is assuming only up to $139 million.[44] The claims bar date has not been set and there is risk that the Debtors' estimate of 503(b)(9) claims is not sufficient. Pursuant to the Debtors' recently filed Statements of Assets and Liabilities, the inventory purchased during the 20 days before the petition date amounts to approximately $370 million.[45] While this amount does not entirely consist of 503(b)(9) claims and may not include inventory received by the Debtors from third parties during the 20-day period prior to filing, without additional information it is reasonable to infer that the Debtors' 503(b)(9) claims could potentially be materially larger than the identified $[redacted].

39. Working Capital Adjustments: Under Sections 2.3(k)(vii)-(ix) of the APA, if the value of certain current assets (specified receivables, warranty receivable and prepaid inventory)

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[42] "Project Blue Rolling Cash Flow Budget (Week 14)" dated January 23, 2019 prepared by the Debtors.

[43] "Project Blue Revised Cash Flow Budget – Going Concern" dated January 11, 2019 prepared by the Debtors.

[44] "Admin Claims Schedules" dated January 13, 2019, prepared by the Debtors.

[45] Dockets, 1609-1713, Schedules of Assets and Labilities filed for the Debtor entities dated January 18, 2019.

is lower than the dollar value that ESL set forth in the ESL APA, thus resulting in a working capital "shortfall", the amount of liabilities ESL has agreed to assume related to severance, 503(b)(9) claims, and accounts payables will be reduced dollar-for-dollar by the shortfall amount.[46] In such an event, the administrative claims shortfall would increase. In fact, as of January 23, 2019, the Debtors' estimates for warranty receivables and prepaid inventory are barely in excess of the targets set forth in the ESL APA.[47] Additionally, per section 2.3(k)(vi) of the ESL APA, if the aggregate balance of the outstanding ABL DIP and Junior DIP loans is lower than the estimated $1.2 billion (i.e. $850 million for the ABL DIP and $350 million for the Junior DIP), then ESL's obligation to assume certain administrative liabilities will be reduced on a dollar-for-dollar basis.[48]

40. Liabilities Remaining with the Debtors: ESL is agreeing to pay for certain liabilities including severance obligations of $43 million, 503(b)(9) claims of $139 million, accounts payable of $166 million, and property taxes of $135 million.[49] However, payments on certain of these claims are not due until and up to 120 days following the closing date or plan confirmation date. If ESL breaches its obligations to pay these assumed liabilities under section 2.3(k)(x) of the ESL APA, the Debtors' recourse is limited to a general unsecured contractual obligation from ESL, yet the Debtors remain responsible for these administrative obligations.

41. Liabilities regarding Employee Benefits: Pursuant to section 9.7(j) of the ESL APA, the Debtors are responsible for the medical, dental, and health claims of eligible

[46] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[47] "Transform Transaction – weekly Tracking" dated January 23, 2019, prepared by the Debtors.

[48] Asset Purchase Agreement by and among Transform HoldCo LLC, Sears Holdings Corporation and its subsidiaries dated as of January 17, 2019.

[49] *Id.*

employees for services rendered prior to the sale closing date.[50] The majority of the Debtors' medical plans are self-insured, and it is not unusual for such benefit related claims to lag due to timing and processing delays. As a proxy to estimate this liability as of the closing date, I have reviewed the Debtors' first day wage motion, which shows that as of the petition date, the Debtors had approximately $19.1 million of these types of obligations.[51]

42. The chart below summarizes my analysis of the Debtors' estimated administrative insolvency and shows that the significant risk that, even after considering all the potential "upsides" and the "downsides," the Debtors will be woefully administratively insolvent following the ESL sale.

[50] *Id.*

[51] ECF No. 31, *Motion of the Debtors for entry of order (i) authorizing the Debtors to(a) pay certain prepetition wages and reimbursable employee expenses, (b) pay and honor employee medical and other benefits, and (c) continue employee benefits programs, and (ii) granting related relief* (Oct. 15, 2018) (stating that as of the petition date, the Debtors has obligations of $17.2 million related to the Debtors' Employee Benefit Programs, $0.4 million of administration cost related to the Employee Benefit Programs and $1.5 million related to the Debtors' Former Employee Benefit Programs).

$ in millions	**Committee's Estimate**
Total Potentail Administrative Claims Shortfall As Of the Time of the Auction	**$226**
Potential Upsides	
1. Inventory Not Being Sold to ESL	[redacted]
2. Value from Credit Bid Release Consideration Reserve	(35)
3. Value from Excess Inventory and Receivables	tbd
4. Reduced Accounts Payable	tbd
5. Historical Favorable Budget to Actual Variance	tbd
Total Potential Administrative Claims Shortfall Considering Only Potential Upsides	**$148 - tbd**
Potential Downsides	
6. Accrued Payroll Due at Closing	[redacted]
7. Warranties and Protection Agreements Liabilities	[redacted]
8. Loss of Cash at Banks	[redacted]
9. Loss of the SHIP Deposit	6
10. Mechanics' Lien Obligations	4
11. Cost of Closing Delays	tbd
12. Unfavorable Budget to Actual Variances	tbd
13. Unfavorable 503(b)(9) Claims	tbd
14. Working Capital Adjustments	tbd
15. Liabilities Remaining With the Debtors	tbd
16. Liabilities regarding Employee Benefits	tbd
Total Potential Administrative Claims Shortfall Considering Both Potential Upsides and Downsides	**$259 +/- tbd**

III. NewCo is at Risk of Breaching its Debt Covenants by as Early as October 2019

43. I reviewed ESL's projected liquidity analysis for the Debtors' going concern business. Based on adjustments to that analysis to account for errors, and the assumptions deemed reasonable contained in Mr. Jan Kniffen's expert report, I determined that NewCo is at risk of breaching its debt covenants by as early as October 2019. My calculations and the adjustments are contained in the attached presentation ("Exhibit A" hereto).

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge. I reserve the right to amend and modify this declaration if new information is presented to me.

New York, New York
January 26, 2019

By:

Matthew Diaz
Senior Managing Director
FTI Consulting, Inc.

FTI CONSULTING

Exhibit A - Assessment of NewCo's Liquidity Analysis

January 26, 2019

Summary Conclusion

ESL Investments, Inc. ("ESL") provided a projected liquidity analysis ("ESL Liquidity Analysis") for the Debtors' going concern business ("NewCo")[1]. This analysis sets forth projections for the monthly periods from the presumed sale on February 9, 2019 ("Closing") to January 2020 ("FY 2019"), as well as for the fiscal years from 2020 to 2023.

- Upon review of these documents, and as discussed further herein, I determined that these analyses needed to be revised to incorporate certain adjustments relating to the following categories ("Adjusted Liquidity Analysis"):
  - Category I: Correcting for calculation errors.
  - Category II: Revising for more reasonable operating assumptions, per the expert report of Jan Kniffen ("Kniffen Expert Report")[2].

As a result of these adjustments, NewCo is projected to breach the Minimum Excess Availability Covenant starting in October 2019[3].

[redacted]

1. ESL-UCC-00005178 - ESL-UCC-00005186
2. Expert Report of Jan R. Kniffen, dated January 26, 2019. The Kniffen Expert Report provides what he opines are three more reasonable assumptions for the FY 2019 liquidity forecast: (1) a decline of [redacted] in same store sales, (2) no improvement in gross margins, and (3) an increase to no more than [redacted] DPO. There are other aspects of ESL's business plan that Mr. Kniffen opines are unrealistic or overly optimistic but does not offer an alternative, empirical assumption that can be incorporated into the Adjusted Liquidity Analysis
3. As defined in the ABL Commitment Letter Dated January 9, 2019, among and between Transform Holdco LLC and certain banks, pages B20 and B21, ¶(e) ("Minimum Excess Availability Covenant")
4. Shown as "Ending ABL Availability" in the ESL Liquidity Analysis, except for May 2019 which includes [redacted] of cash as shown on page 8 of the ESL Liquidity Analysis
5. Shown as the "FCCR Reserve" in the ESL Liquidity Analysis

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Category I: Correcting for Calculation Errors

The ESL Liquidity Analysis contains an error that I have corrected in the Adjusted Liquidity Analysis.

1. Incorrectly Calculated the Source of Cash from Accounts Payable

- Overview: The ESL Liquidity Analysis shows an accounts payable balance of [redacted] at Closing and [redacted] at the end of February. When accounts payable increases, this is a source of cash as the business has deferred paying its bills. When accounts payable decreases, this is a use of cash as the business has paid outstanding bills.
- ESL Liquidity Analysis: This analysis assumes a [redacted] source of cash for February, [redacted] for March, [redacted] for April, [redacted] for May, etc.
- Adjusted Liquidity Analysis: In calculating the [redacted] source of cash in February, the ESL Liquidity Analysis does not seem to take the [redacted] accounts payable balance at Closing into account. A [redacted] source of cash implies that the accounts payable balance increases by [redacted] in February. In fact, the accounts payable balance decreased by [redacted].
  - Therefore, the cash flow for February in the ESL Liquidity Analysis is overstated by [redacted]
- Impact: This [redacted] error is a permanent difference and causes liquidity to be reduced by [redacted] in every month.

[redacted]

1. As shown on page 8 of the ESL Liquidity Analysis
2. As shown on page 7 of the ESL Liquidity Analysis

Category II: Revising for More Reasonable Operating Assumptions

Based on the Kniffen Expert Report, certain operating assumptions included in the ESL Liquidity Analysis are aggressive, and I changed them in the Adjusted Liquidity Analysis to be more reasonable.

2. Same Store Sales ("SSS") Adjustment

- Overview: The same store sales metric measures the amount of sales generated compared to the year prior for the same set of stores. In the ESL Liquidity Analysis, ESL uses various SSS assumptions to estimate go-forward revenue for its brick and mortar stores.
- ESL Liquidity Analysis: Page 2 of the ESL Liquidity Analysis indicates [redacted] in SSS for FY 2019 for the brick and mortar business segment.
- Adjusted Liquidity Analysis: Based on the Kniffen Expert Report, the SSS decline of [redacted] is a more reasonable assumption for retail stores in FY 2019[1].
- Impact: By adjusting the SSS assumption to [redacted] retail sales are reduced to [redacted] for FY 2019. At an ESL assumed gross margin of [redacted], the projected impact on liquidity is [redacted] as shown in the table below.
  - Of note, every incrementa[redacted] change to the SSS assumption equates to a [redacted] cumulative impact on liquidity for FY 2019. For example, if SSS were [redacted] the cumulative liquidity impact for FY 2019 would be [redacted], or [redacted] less than the chart shown below. Similarly, if SSS were [redacted] the cumulative liquidity impact would be [redacted], or [redacted] more than the chart shown below.

[redacted]

1. Kniffen Expert Report, Para. 86
2. Based on the retail revenue numbers shown on page 6 of the ESL Liquidity Analysis, adjusted for the [redacted] SSS assumption
3. As shown on page 6 of the ESL Liquidity Analysis
4. Based on the retail gross margin dollars divided by the retail revenue amounts as shown on page 6 of the ESL Liquidity Analysis

Category II: Revising for More Reasonable Operating Assumptions (cont.)

3. **Gross Margin Adjustment**

- Overview: Gross margin reflects the percentage of gross profit to revenue.
- ESL Liquidity Analysis: Page 2 of the ESL Liquidity Analysis indicates that retail stores are assumed to have a gross margin [redacted] in FY 2019, compared to FY 2018.
- Adjusted Liquidity Analysis: Based on the Kniffen Expert Report, keeping FY 2019 gross margin for retail stores constant with FY 2018 is a more reasonable assumption[1].
- Impact: With retail sales of [redacted] (using the [redacted] SSS assumption), a [redacted] in gross margin has a [redacted] cumulative liquidity impact for FY 2019 as shown in the table below.
  - Of note, every incremental [redacted] change in the gross margin adjustment equates to a [redacted] impact on liquidity. For example, if the gross margin adjustment were [redacted] the cumulative liquidity impact for FY 2019 would be [redacted], or [redacted] less than the chart shown below. Similarly, if the gross margin adjustment were [redacted] the cumulative liquidity impact for FY 2019 would be [redacted], or [redacted] more than the chart shown below.

[redacted]

1. Kniffen Expert Report, Para. 91
2. Based on the retail revenue numbers shown on page 6 of the ESL Liquidity Analysis, adjusted for the [redacted] SSS assumption

Category II: Revising for More Reasonable Operating Assumptions (cont.)

4. Days Payable Outstanding ("DPO") Adjustment

- Overview: Days Payable Outstanding is an efficiency ratio that measures the average number of days it takes for a company to pay its suppliers. If a company can extend its DPO, that can be a source of cash as payments are extended to later dates. This source of cash can be used for other activities, such as the paydown of debt.
- ESL Liquidity Analysis: Page 3 of the ESL Liquidity Analysis assumes NewCo's DPO starts at [redacted] days in February, with gradual increases between March and June, before reaching [redacted] days in July, where it will remain constant for the remainder of FY 2019. This means that as the year progresses, NewCo has more time to pay its suppliers, and thus can borrow less money from its debt facilities.
- Adjusted Liquidity Analysis: Based on the Kniffen Expert Report, capping DPO at [redacted] days for the remainder of FY 2019[1], which is consistent with the Debtors' prepetition accounts payable terms as listed on page 3 of the ESL Liquidity Analysis, is a more reasonable assumption.
- Impact: Capping the DPO terms to [redacted] days from up to [redacted] days means that for the months of July 2019 – January 2020, NewCo will have less credit from its vendors. The monthly impact to liquidity ranges from [redacted] to [redacted] as shown in the table below.

[redacted]

1. Kniffen Expert Report, Para. 111
2. As shown on page 8 of the ESL Liquidation Analysis
3. Implied payables per day is calculated as the monthly A/P balance divided by the DPO. For example, the [redacted] of implied payables per day for February represents the A/P balance of [redacted] divided by the DPO of [redacted] days

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Difference in ABL Interest Due to Change in Cash Flows

5. Cumulative Difference in ABL Interest Due to Change in Cash Flows

- Overview: NewCo's ABL facility is a revolving line of credit that can be drawn when cash is needed (subject to a borrowing base) and paid back when there is excess cash. The annual interest rate on NewCo's ABL Facility is L + 375, or 6.05%[1].
- ESL Liquidity Analysis: N/A
- Adjusted Liquidity Analysis: The Category I and Category II adjustments will cause NewCo to borrow more money under its ABL facility, which will cause additional interest expense than what was forecasted in the ESL Liquidity Analysis.
- Impact: As a result of incurring additional interest associated with the Category I and Category II adjustments, the cumulative effect on liquidity is projected to be [redacted] as shown in the table below.

[redacted]

1. The LIBOR rate is assumed to be 2.3%, per ESL-UCC-00004499, per tab "Projections BS and CF" cell D5

Exhibit C

Kniffen Report

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
SEARS HOLDINGS CORPORATION, et al.,	Case No. 18-23538 (RDD)
	(Jointly Administered)
Debtors.	

EXPERT REPORT OF JAN R. KNIFFEN

January 26, 2019

Table of Contents

I. Introduction and Qualifications

A. Qualifications

1. My name is Jan Rogers Kniffen. I have worked in senior and executive positions in the retail and apparel industry and the retail consulting and research industry with a focus on finance and operations. I have been creating, analyzing and reviewing business plans for almost five decades. I began my career at ACF Industries, Inc., a Fortune 500 company, where I was promoted to the role of Director of Business Planning for one of its divisions. During this period, I was an associate professor at Lindenwood University and one of the classes I taught in the MBA program was Strategic Planning.

2. From 1985 through 2005, I worked at The May Department Stores Company ("May"), which operated various department, discount and specialty stores and developed, owned, and operated its own regional shopping malls. As the company's senior vice president and treasurer, I was responsible for managing many aspects of May's retail business, including long-term financial planning, acquisition analysis, investor relations, public relations, treasury operations, tax, and risk management. I oversaw numerous acquisitions and divestitures, including, among others, the acquisition of Marshall Field's, the divestitures of Payless ShoeSource, Venture Stores, Inc., and Caldor Inc., and the sale and leaseback of approximately 100 department stores. I also served on the Financial Disclosure Committee, and as liaison to the Finance Committee of the Board of Directors. I chartered and was president of May's three national banks, and was president of two captive insurance subsidiaries.

3. From 1991 until 2005, as a senior vice president and liaison to the Finance Committee of the Board of May, I was responsible for evaluating every new store, whether built or acquired, against the five-year plan for that store and reporting those findings every year to the Finance Committee. During this period, the reporting encompassed approximately 37 newly built or acquired department stores per year, more than 100 new shoe stores per year, and more than 40 newly remodeled stores per year. I also explained (1) each store's variance to plan based on the cost to build or acquire; (2) the timing of the store's opening versus plan; (3) sales performance and expense performance; (4) projected return on investment ("ROI"), whether negative or positive; and also (5), reported on plans to

improve each store's performance versus plan, or to recognize and evaluate positive variances to improve the forecasting process. That, in conjunction with my role of forecasting the five-year performance plan for the entire corporation and reporting variances to those forecasts every year, has enhanced my ability to evaluate forward-looking plans in the retail industry. Notably, my planning experience includes planning for department stores, discount stores, and specialty stores.

4. I worked on, planned, analyzed, and incorporated in the May business plan more than thirty acquisitions and/or operational restructurings of its retail business. Those projects included, but are not limited to, the following:

- My first project, the one for which May hired me, was the acquisition of the Associated Dry Goods Company, the operator of department stores, discount stores, off-price stores, and specialty stores. My role was to conduct the financial modeling for the acquisition, including the impact of divestitures likely to occur post-closing, and to establish the capital structure of the newly merged company. My role also involved incorporating those changes into May's five-year plan. When the Associated Dry Goods transaction closed in 1986, it was the largest acquisition in the history of retailing.

- In 1988, I planned the acquisition of Federated Department Stores and modeled each of the various structuring possibilities contemplated over the course of the transaction, which culminated with May acquiring two department store divisions from Federated. Those two divisions required immediate incorporation into the five-year planning process.

- In 1989, I planned and modeled the sale of the Caldor discount stores to a private equity firm, including the impact of the sale on the May five year plan.

- In 1990, I managed, modeled, and designed the capital structure for the tax-free spin-off of Venture Stores, a discount division of May, and incorporated the transaction into the May five-year plan.

- Between 1990 and 1992, I planned, modeled, and designed the capital structure for a transaction whereby May entered into a partnership with The Prudential Insurance Company that included the sale and leaseback of 100 department stores and a joint venture to operate 26 regional shopping malls. The transaction led to the eventual unwinding of the partnership, divesting May's interest in the shopping centers, and repurchasing the 100 department stores. I was responsible for modeling the impact of that complicated set of transactions into the May five-year plan.

- In 1995, I planned, modeled, designed, and funded the capital structure to purchase the John Wannamaker stores in Philadelphia, PA, another addition to the five-year

planning process.

- In 1995, I modeled the acquisition of 550 shoe stores from Kobacker and Shoe Works, an acquisition that had a meaningful impact on the five-year plan when it was executed.

- In 1996, I planned, modeled, led the roadshow for and executed the tax-free spin-off of the Payless ShoeSource subsidiary of May, and the purchase of Strawbridge and Clothier, a chain of department and discount stores in Philadelphia, PA, and incorporated both of those transactions into the long range planning process of May.

- In 1998, I modeled and planned the capital structure for the acquisition of Mercantile Stores, eventually resulting in the acquisition of The Jones Store, a department store chain in Kansas City, MO, and the acquisition of Castner Knott, a department store chain in Nashville, TN, which required incorporation into the five-year plan.

- In 1999, I planned, modeled, and funded the acquisition of Zion's Cooperative Mercantile Institution, a chain of department stores in Salt Lake City, UT, and modeled its impact on the five-year plan.

- In 2000, I planned, modeled, and funded the acquisition of David's Bridal, the largest bridal gown business in the U.S. This acquisition added a new complication to the five-year planning process since it immediately moved May into the position of the largest seller of bridal gowns in the country.

- In 2001, I planned, modeled and funded the acquisition of After Hours Formalwear, at the time the largest tuxedo rental business in the U.S. This acquisition, too, resulted in a major change in the five-year planning process as May became the number one retailer in the business of renting tuxedos, which included becoming the largest dry cleaner in the U.S.

- In 2002, I planned and modeled the acquisitions of Pricilla of Boston.

- In 2003, I planned, modeled, and funded the \$3.2 billion purchase of Marshall Field's, a department store chain in Chicago, IL, resulting in one of the biggest re-planning efforts in the history of the May five-year planning process.

5. During my tenure at May, the company also internally restructured from 25 operating divisions down to seven operating divisions. Each of those mergers or divestitures of divisions required a plan that rolled into the company's five-year plan.

6. Each of the projects described above required valuing the new or acquired business before integration into May, and a restructuring plan that included modeling the projected

performance of the new or acquired business upon its integration into May. I was directly involved in modeling both of these scenarios for each of the transactions described above. The success of May's mergers required forecasting and managing reductions in the expense structure, the elimination of senior management staff, and the combination of buying staffs. Our forecasts modeled the tradeoff between short-term cost savings and the impact to sales, gross margins, and ROI in both the short and longer terms.

7. From 1985 through 2005, I was also responsible for evaluating the performance of May's competitors, including Sears, and comparing their performance to May's performance for the May Finance Committee. In any given year, I was responsible for the quarterly evaluations of approximately 25 public retailers that competed with some aspect of May's business. Therefore, I examined a wide range of retailers' quarterly performance based on their ROI, leverage, revenue or "top line" performance, net income or "bottom line" performance, and measures between those two lines, including gross margin performance, selling general and administrative ("SG&A") expenses, tax rate, and one-time events.

8. I left May after it was acquired by Federated Department Stores (now Macy's, Inc.), and founded a retail consulting company, J. Rogers Kniffen Worldwide Enterprises, which I continue to run. In this role, I provide financial and management consulting services to the retail and apparel industry and investors in the retail business on topics such as acquisition due diligence, benchmarking, competitive analyses, financial analysis, investor relations, and market assessments. I regularly appear as a contributor for retail news on CNBC and I am frequently quoted in the media on topics related to the retail and apparel industry. I hold an MBA degree from Lindenwood University in Missouri.

9. My extensive knowledge about Sears and Kmart long precedes my current role as an executive in the retail and retail consulting business. May regarded Sears as both a competitor and a partner in anchoring malls. My team and I evaluated Sears and its performance every quarter for twenty years and reported our evaluations to May's Board of Directors. I also note that May's senior executives, including myself, were required to read The Big Store, a book published in 1988 about the challenges facing Sears and management's response so that we could learn from Sears's mistakes and successes in

department store and mass merchant retailing. I have continued to follow Sears as a retail investment consultant and have publicly commented on its performance as an expert on CNBC.

10. A copy of my CV is attached as **Appendix A**, which includes my past expert testimony. My standard hourly rate, which I am charging on this matter, is $975. My compensation is not contingent upon the substance or nature of the opinions that I form or the outcome of this case. Others working under my supervision and direction have assisted me in this matter. I have not written any books nor had any peer reviewed research published in the last 10 years. My various writings can be found on my website, https://www.jrkwwe.com.

B. Assignment

11. On October 15, 2018, Sears Holdings Corporation ("Sears" or the "Company") filed for bankruptcy. On January 17, 2019, ESL Investments, Inc. ("ESL") was declared the winner of an auction with a bid of $5.2 billion.[1] I have been retained by counsel for the Official Committee of Unsecured Creditors of Sears to analyze the viability of post-bankruptcy Sears (also referred to as "Sears NewCo") following its proposed acquisition by ESL. Specifically, I was asked to review the proposed business plan for reorganized Sears and to assess the reasonableness of ESL's financial projections and liquidity forecast (collectively referred to as the "2019 ESL Business Plan" or the "Plan" in my report).[2]

C. Materials Considered

12. My opinions are based on the materials referenced in this report and my more than 40 years of experience as a senior executive in finance and in operational roles in the retail and apparel industry and as a consultant evaluating retailers and their performance. My research and analysis focused on the following topics: (a) Sears's financial performance

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1 *See* Lauren Thomas & Lauren Hirsch, "Sears Announces Lampert's Hedge Fund, ESL, as Winning Bid in Bankruptcy Court Auction," *CNBC* (Jan. 17, 2019 11:36 AM), https://www.cnbc.com/2019/01/17/sears-announces-esl-as-winning-bid-in-bankruptcy-auction html.

2 *See* ESL Investments, *Project Transform – Business Plan*, January 2019 [hereinafter "2019 Project Transform Business Plan"] (RS_UCC_00000682); ESL Investments, Project Transform – *Liquidity Analysis*, January 14, 2019 [hereinafter "2019 Project Transform Liquidity Analysis"] (ESL-UCC-00005178).

prior to bankruptcy, (b) the restructuring and other business initiatives proposed by ESL, (c) related historical experience of department stores, big box stores, and other similar retailers, and (d) the current outlook for the retail industry. The types of materials referenced in this report, including industry reports and trends, company financial reports, financial projections, and restructuring plans, are the kinds of materials that experts like myself review on a regular basis as part of our profession. Counsel also provided me with the transcripts of interviews and depositions for key participants from Sears, ESL, and others involved in Sears's bankruptcy and proposed restructuring. A list of the materials I have considered is included in **Appendix B** to this report. I reserve the right to update my conclusions or opinions should additional information be provided to me and to supplement or to amend them to address any additional expert opinions offered in this proceeding.

II. Summary of Opinions

13. My primary opinion in this matter is that, given Sears's historical performance under ESL's ownership and control, its current position within the retail industry, and the current department store outlook, ESL's financial projections for a post-bankruptcy Sears are unrealistic and unreasonable.[redacted]. Based on my decades of experience compiling and assessing retail industry business plans and projections, including my prior knowledge of Sears, and my review of materials in this case, a more reasonable and realistic expectation is that, should Sears pursue the Plan, it would continue its longstanding, downward trajectory of divesting assets, cutting jobs, and losing money.

14. Under ESL's ownership and control for the past approximately 15 years, Sears has experienced poor financial performance, including significant revenue declines, as the Company underinvested in key aspects of the business and failed to respond to the competitive challenges and changes in the industry. The Company also prepared unrealistic financial forecasts during this period. Under ESL's ownership and control:

- Sears divested or closed thousands of stores and several brands and laid off the majority of its employees. Moreover, same-store sales also declined, which suggests that former customers of closed Sears stores turned to other retailers rather than to

the remaining Sears stores for their goods.

- Sears's management team minimally invested in its stores and overall business and failed to make strategic investments in the business necessary for Sears to remain competitive in an ever-changing retail environment. Indeed, Sears's management failed to adapt to the seismic shifts in the retail industry landscape. Three factors, in particular, have further stressed Sears's financial viability in recent years: (1) the continued growth and expansion of big box chains such as Walmart, Target, Home Depot, and Lowe's; (2) substantial expansion of online retail sales via Amazon and others; and (3) a decline in the type of regional malls where Sears had historically enjoyed success. These industry forces persist today and Sears, in its current weakened state, is not well positioned to compete.

- Sears's management team prepared unrealistic and overly optimistic sales and profitability targets. [redacted] In my opinion and based on my experience, such an approach does not produce reliable financial forecasts and contributed to the history of unrealistic financial planning for Sears.

- Sears's management team proposed plans to reverse the Company's deteriorating financial condition but these plans have proved unsuccessful.

15. In my opinion, numerous flaws in the 2019 ESL Business Plan render the financial projections contained therein unrealistic and unreasonable. The Plan relies on unproven initiatives that are speculative at best. [redacted] The Plan's deficiencies include the following:

- [redacted] Even though the store closings over the past 8 years have failed to stabilize (let alone improve) same-store sales trends, [redacted] This, in my opinion, is a

critical flaw and unrealistic assumption in the Plan.

- [redacted]. In my experience, it is challenging to reduce costs with minimal disruption. [redacted].

16. In addition to the above flaws in the Plan's projections and underlying assumptions, [redacted] Based on my experience in the industry, I expect that it will be difficult for Sears to attract and retain top level talent given its declining business and workforce, competitive landscape, and apparent pressures for management to achieve unrealistic targets.

17. [redacted]

18. Thus, I conclude that it is highly speculative to presume that ESL and Sears can achieve this Plan. To the contrary, it is more reasonable to expect that Sears would continue closing stores, laying off employees, and shrinking the business.

III. Under the Ownership and Control of ESL, Sears Has Had a History of Poor Financial Performance, and Has Underinvested in Key Aspects of the Business, and Failed to Respond to Competitive Challenges and Changes in the Industry

19. In this section of my report, I describe Sears's financial performance during the nearly 15-year period that ESL has controlled it. I also describe, at a high level, key industry forces that have contributed to Sears's difficulties. During this period, ESL formulated periodic business plans, which included targets that Sears typically missed by large amounts. In my opinion, Sears's historical performance, industry trends, and the current

position of the Company provide an important foundation for assessing the reasonableness and reliability of the 2019 ESL Business Plan.

A. ESL Purchased Sears and Merged It with Kmart 15 Years Ago

20. Sears, Roebuck and Company was a chain of department stores founded in 1886.[3] ESL acquired the majority stake in Kmart Corporation as it emerged from bankruptcy in May 2003.[4] On November 17, 2004, ESL acquired Sears, Roebuck and Co. and merged it with Kmart to form Sears Holdings Corporation. Following the transaction, Mr. Edward Lampert, the founder of ESL, served as the Chairman of the combined entity and ESL has since controlled the operations of the combined entity.[5]

21. Sears's core operating business segments consist of Sears and Kmart retail stores, home delivery services ("Innovel"), auto services ("Sears Auto Center"), and appliance installation, repair, and maintenance services ("Sears Home Services").[6] The Sears and Kmart retail stores account for over 80 percent of Sears's sales.[7] As of November 3, 2018, Sears operated a network of 766 full-line and specialty stores in the U.S. under the Sears and Kmart brand names.[8] Sears also had a presence online through sites including Sears.com, Kmart.com, and ShopYourWay.com.[9] Online sales represented 16 percent of Sears's total sales in 2018.[10] In addition to the retail and services business, Sears also operated proprietary brands including Kenmore and DieHard.[11] Among these brands,

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3 *See* Sears, Roebuck and Co., 2003 Form 10-K, filed Mar. 10, 2004, pp. 2-3.

4 *See* Kmart Holding Corp., 2004 Form 10-K, filed Mar. 9, 2005, p. 11; *see also* Andrew Bary, "Attention! *See also* Kmart Holders," *Wall St. J.*, July 19, 2004, https://www.wsj.com/articles/SB109002109223466280; Constance L. Hays, "Market Place; A New Start, A New Name. But Have Things Really Changed as Kmart Comes Out of Bankruptcy?" *N.Y. Times* (May 7, 2003), https://www nytimes.com/2003/05/07/business/market-place-new-start-new-name-but-have-things-really-changed-kmart-comes html.

5 *See* Sears, Roebuck and Co., 2004 Form 10-K, filed Feb. 23, 2005, p. 2.

6 *See* Sears Holdings Corp., 2017 Form 10-K, filed Mar. 23, 2018, pp. 2-4.

7 *See* 2019 Project Transform Business Plan, p. 40 (RS_UCC_00000682 at RS_UCC_00000722).

8 *See* Sears Holdings Corp., 2018 Form 10-Q for Quarterly Period Ended November 3, 2018, filed Dec. 13, 2018, p. 9.

9 *See* 2019 Project Transform Business Plan, p. 40 (RS_UCC_00000682 at RS_UCC_00000722).

10 *See* 2019 Project Transform Business Plan, p. 40 (RS_UCC_00000682 at RS_UCC_00000722).

11 *See* Sears Holdings Corp., 2017 Form 10-K, filed Mar. 23, 2018, pp. 2-3.

Kenmore is the most significant with approximately 8.8 percent share of the appliance market.[12] DieHard's share of the auto battery market is approximately four percent.[13]

B. Sears's Financial and Operational Deterioration Long Precedes Its Bankruptcy Filing

i. Sears's Business Has Been Declining for Over a Decade

22. Sears has been declining for over a decade, despite management's attempts to improve the business. Sears's deterioration is characterized by its poor financial performance and much smaller physical footprint for its brick and mortar stores.[14]

23. Sears's deterioration is well-recognized by industry analysts and the media more broadly. In February 2017, I expressed my own doubts on CNBC about Sears's promise to effect a turnaround through $1 billion in further cost reductions. At that point, Sears had already engaged in repeated rounds of cost-cutting without achieving its desired turnaround. Thus, I explained on CNBC that, "the store quality has gotten worse, and the service has gotten worse, and the display has gotten worse. It's very hard to get better when you keep slashing expenses."[15] Industry analysts have also noted Sears's poor performance over at least the past seven years. For example:

- In January 2012, Standard and Poor's analysts described Sears Holdings as a "combination of two underperforming retailers" whose "sales and profitability had consistently declined" and that had "underinvest[ed] in its stores relative to peers."[16]

- In May 2017, Evercore ISI analysts stated that "[s]ales remain in a state of freefall decline" and that "[g]iven the very weak store base, continued comp declines, anemic sales productivity, and continued share loss in most major categories, [Sears] does not appear well positioned."[17]

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12 *See* 2019 Project Transform Business Plan, p. 23 (RS_UCC_00000682 at RS_UCC_00000705).

13 *See* Sears Holdings Corp., Preliminary Business Plan, December 2018, p. 50.

14 2019 Project Transform Liquidity Analysis, p. 4 (ESL-UCC-00005178 at ESL-UCC-00005182).

15 Jan Kniffen, "Sears Can't Cut Costs Successfully: Pro," *CNBC* (Feb. 10, 2017 2:17 PM), https://www.cnbc.com/video/2017/02/10/sears-cant-cut-costs-successfully-pro.html.

16 Standard & Poor's Ratings Services, "Sears Holdings Corp.," Jan. 25, 2012, p. 2.

17 Evercore ISI, "1Q Update - Don't Fear the Reaper," May 25, 2017 [hereinafter Evercore ISI, "Don't Fear the Reaper"], pp. 1-2.

- In June 2018, Susquehanna Financial Group analysts noted that "Sears' core operations continue to decline and we remain as doubtful as ever on the management's ever-ongoing turnaround plan. The environment for Sears is only going to get more competitive as other larger, more profitable retailers get a boost from lower tax rates and reinvest in their business, which Sears would not be able to do. Sears also faces higher borrowing costs due to elevated debt levels and rising interest rates." The analysts also stated that "Sears' return to profitability is a very bumpy road, and we expect Sears will continue to pare corporate expenses and reduce headcount as it struggles to survive. Further store closures and asset sales are imminent."[18]

- In October 2018, J.P. Morgan analysts stated that "We have been expecting Sears to file for bankruptcy for years, as the company has not generated positive EBITDA since 2012, and has burned cash (OCF – Capex) since 2010 (cumulatively >$11bn) … The writing has been on the wall as each successive real estate sale came at a lower valuation and each successive debt financing came at a higher cost."[19]

24. [redacted]

Exhibit 1
Sears Historical Total Revenue and Total Number of Sears Stores
2010 - 2018

[redacted]

18 Susquehanna Financial Group, "Sears Holdings: FQ1:18: Performance Erosion Accelerates as Corp Talking Points Ring More Hollow," June 1, 2018, pp. 1-2.

19 J.P. Morgan, "Digging Deeper: Another One Bites The Dust? Cross-Asset Class SHLD Primer Points & Laterals," Oct. 11, 2018, p. 6.

25. [redacted]

Exhibit 2
Sears Historical EBITDAP
2010 - 2018

[redacted]

26. Sears closed stores in an attempt to counteract its deteriorating financial performance. As also shown above, the total number of Sears's brick and mortar stores nationwide declined from over 4,000 stores in 2010 to 505 stores by year-end 2018, or a decline of more than 87 percent. As I discuss later in Section IV, [redacted].[21]

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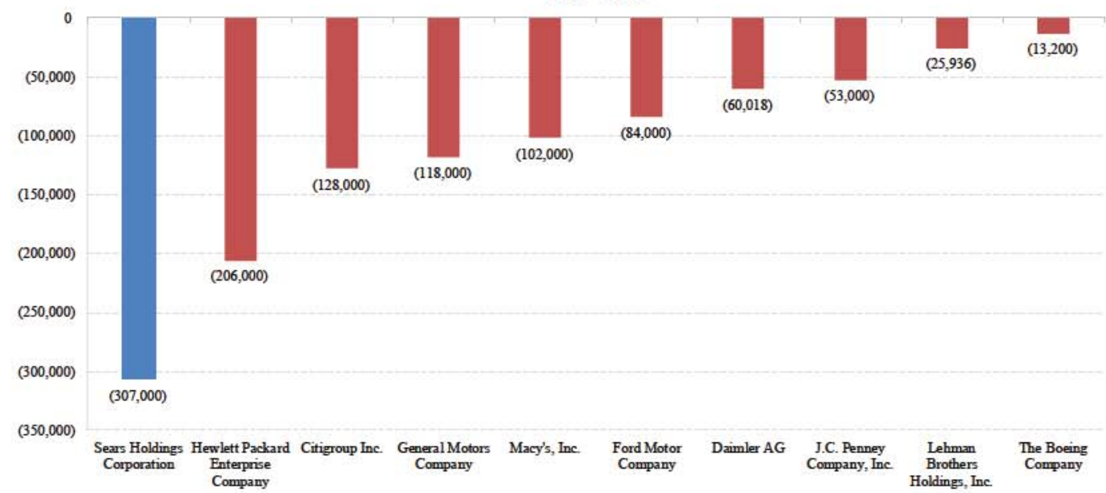
[20] I understand that when Sears uses EBITDA it excludes pension payments, so it could also be labeled as EBITDAP.

[21] *See* 2019 Project Transform Business Plan, p. 4 (RS_UCC_00000682 at RS_UCC_00000686). [redacted] *ee also* 2019 Project Transform Liquidity Analysis, p. 6 (ESL-UCC-00005178 at ESL-UCC-00005184).

27. Sears's past poor performance and store closures had a significant negative impact on its workforce over the last decade. As shown in Exhibit 3, Sears cut 307,000 jobs between 2007 and 2018, more jobs than any other major corporation during the same period. The total number of jobs that Sears cut is nearly 3.5 times the total number of employees that remained as of February 2018.[22] As shown in Exhibit 3, Hewlett Packard, which carried out the next largest number of job cuts over the same period, cut approximately one-third fewer jobs than Sears.

claims to save 45,000 jobs. Given that Sears had 68,000 employees at the time it filed for bankruptcy, it would need to cut one-third of its existing employees to achieve the 45,000 headcount .[23]

Exhibit 3
Total Job Cuts
2007 - 2018



28. In addition to retail store difficulties, the major brands still owned by Sears have also faltered. The Kenmore brand had historically held a sector-leading position in the appliances market.[24] [redacted]

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22 *See* Exhibit 24.

23 *See* Alistair Gray, "Sears Races to Avoid Outright Liquidation after Bankruptcy Filing," *Fin. Times* (Oct. 15, 2018), https://www ft.com/content/57cd862a-d038-11e8-a9f2-7574db66bcd5. *See also* 30(b)(6) Deposition of ESL Investments, Inc., by Its Corporate Representative Kunal Kamlani at 153, *In re: Sears Holdings Corp., et al.* (Jan. 23, 2019) [hereinafter "Kamlani Dep."].

24 *See, e.g.*, Chris Isidore, "How the Once-Proud Kenmore Brand Ended Up On the Scrap Heap," *CNN Business* (Sept. 4, 2018 1:03 PM), https://money.cnn.com/2018/09/01/news/companies/sears-kenmore/index.html; Jan Wolfe, "Sears' Plan to Sell Brands No Salve for Financial Woes," *Reuters* (Mar. 23, 2017), https://www reuters.com/article/us-sears-restructuring-brands-analysis/sears-plan-to-sell-brands-no-salve-for-financial-woes-idUSKBN16U2PX.

[redacted].[25] The brand's value has declined along with its loss of market share. Sears valued the Kenmore brand at $2 billion more than fifteen years ago, and yet by May 2017, retail analysts valued the brand at only $750 million.[26] In August 2018, ESL itself offered to buy Kenmore for $400 million, or 20 percent of its original value.[27] Similarly, the market share of Sears's automotive brand DieHard has also decreased.[28]

ii. Sears Has Underperformed Compared to Its Competitors

29. In this section, I compare the financial performance of Sears to the firms listed as comparable in the combination of analyst reports, Thomson, and Capital IQ, and show that Sears has underperformed relative to its peers. In particular, I compared Sears to Macy's, Kohl's, J.C. Penney, Dillard's, WalMart, Home Depot, Target, Lowe's, and Best Buy. Exhibit 4 compares Sears's same-store sales growth to the same-store sales growth reported by these comparable firms. As shown, Sears's same-store growth was significantly worse than each of the comparable firms in 2015, 2016, and 2017.

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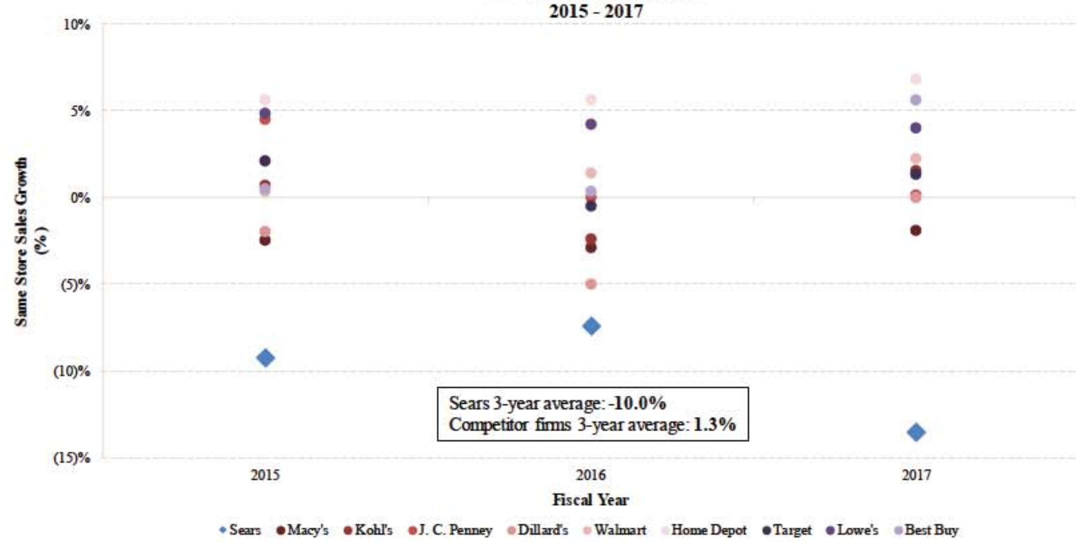
25 *See* 2019 Project Transform Business Plan, p. 23 (RS_UCC_00000682 at RS_UCC_00000705).

26 *See* Isidore, *supra* note 24.

27 *See* Kanishka Singh, "Sears CEO's Hedge Fund Offers to Buy Kenmore Brand for $400 Million," *Reuters* (Aug. 14, 2018 8:09 PM), https://www reuters.com/article/us-sears-holding-divestiture/sears-ceos-hedge-fund-offers-to-buy-kenmore-brand-for-400-million-idUSKBN1L000C; *see also* Evercore ISI, "Don't Fear the Reaper", *supra* note 17, p. 3.

28 Wolfe, *supra* note 24.

Exhibit 4
Comparison of Sears and Select Competitors
Same Store Sales Growth
2015 - 2017



C. ESL and Sears Failed to Respond to Competitive Challenges and Changes in the Industry

30. Sears's significant operational and financial difficulties, which I have described above, reflect major industry-wide changes in the highly competitive retail environment. In this section, I explain how under ESL's management, Sears underinvested in key aspects of the business and divested assets from the business, rendering Sears unable to effectively compete in the changing industry. Although Sears's management engaged in initiatives intended to address Sears's problems, the efforts failed to improve Sears's performance. Instead, as I described earlier, Sears continued to reduce assets, jobs, and revenue.

i. Sears Is Ill-Prepared to Face Industry-Wide Headwinds

31. The retail industry is a highly competitive environment that has gone through significant changes in the last decade. Industry observers widely recognize that the retail environment for Sears's mall-based stores and discount stores has reached historic difficulty levels, as, among other things, Walmart, Target, Costco, Home Depot, Lowe's, and Amazon have grown in strength.[29] Additionally, the malls in which mall-based

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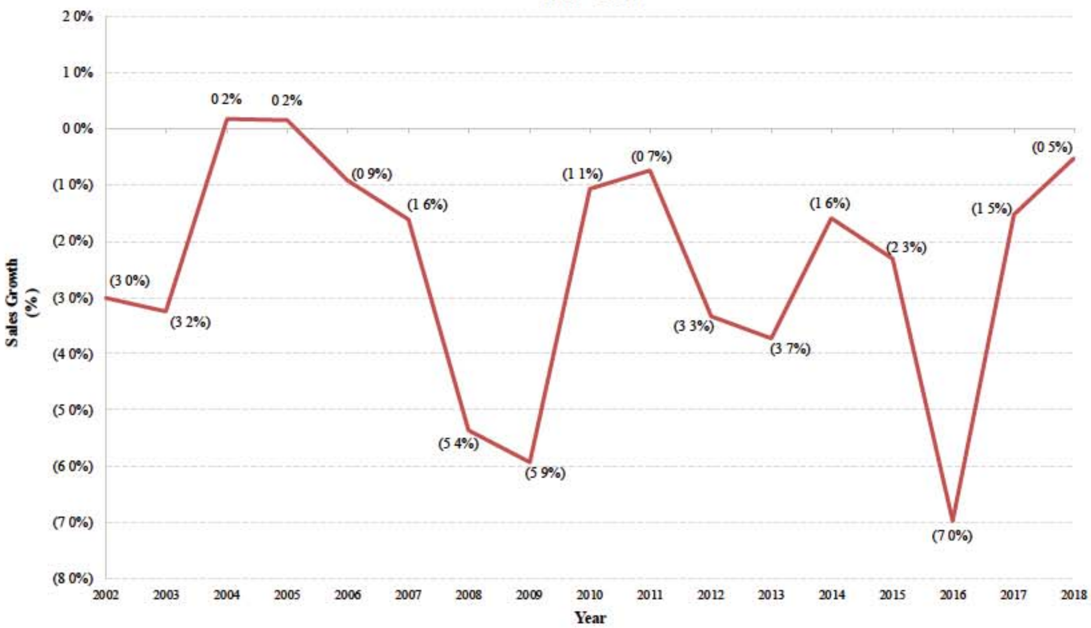
29 *See* Chris Isidore, "Things Are Bad at Sears. They're Worse at Kmart," *CNN Business* (Oct. 21, 2018 4:10 PM), https://www.cnn.com/2018/10/21/business/sears-bankruptcy-kmart/index html; *see also* S&P Global Ratings, "Research Update: Sears Holdings Corp. Downgraded to 'CCC' from 'CCC+' on Need to Address Mid-2018 Maturities; Outlook Negative" (Oct. 27, 2017), p. 3.

retailers like Sears operate have experienced a consistent decline in traffic, unabated even by what is arguably the best consumer environment in decades.[30]

32. Various financial and operational measures demonstrate the challenges in the retail industry generally. For example, in 2017, the five-year retail revenue growth rate among the top 250 companies in the retail industry was down to 3.3 percent, having declined from 9.1 percent in 2006 and 5.4 percent in 2011.[31] Similarly, the median Return on Assets ("ROA") in the retail industry declined to approximately 6 percent, which was lower than the ROA during the financial crisis in 2008 and 2009.[32] As shown in Exhibit 5, department store sales have been declining since 2006, reaching declines as deep as 7 percent in 2016.

Exhibit 5
U.S. Department Store Sales Growth
2002 - 2018



33. The number of retail store closures peaked in 2017 with 8,640 store closings. 2018 included store closures by large-scale retailers such as Toys "R" Us and Sam's Club.[33]

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30 *See, e.g.*, The Conference Board, "The Conference Board Consumer Confidence Index Increased Again in October" (Oct. 30, 2018).

31 *See* Deloitte, "Global Powers of Retailing 2019," p. 12; Deloitte, "Global Powers of Retailing 2018," p. 10.

32 The equivalent ROA in 2006 was 9.5 percent. *See* Deloitte, "2019 Retail Outlook," p. 5.

33 *See* Credit Suisse, "Apparel Retail & Brands: Making Sense of Softlines Following a Tumultuous Twelve Months" (May 2017), p. 10.

Several other retail companies filed for bankruptcy in 2018. In February 2018, Bon-Ton Stores Inc., one of the largest department store companies in the country, filed for bankruptcy with nearly $1 billion in debt.[34] A month later, the mall-based retailer Claire's filed for bankruptcy as declining mall traffic made it difficult to meet its debt obligations.[35] Soon after, in April 2018, the retailer Nine West Holdings, owner of the Nine West and Anne Klein apparel brands, filed for bankruptcy in hopes of reducing its debt load and focusing on its more profitable brands.[36] Gymboree, a retailer of children's apparel, filed for bankruptcy twice. The company was restructured after the June 2017 filing, but survived for just 18 months and has now commenced a second bankruptcy proceeding in which it intends to cease operations and liquidate.[37]

34. The rise of e-commerce is a significant driver of the traditional brick and mortar retailers' financial and operational challenges. Industry experts expect this trend to continue. In 2017, online retail sales accounted for approximately 12 to 13 percent of all retail sales.[38] Retail industry experts expect that, by 2022, online sales will account for between 17 to 20 percent of all U.S. retail sales, and will account for 25 percent of U.S. retail sales within the next decade.[39] Similarly, according to industry analysts, under a scenario

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[34] *See* Jessica DiNapoli, "Bon-Ton Stores Clinches Bankruptcy Financing-Sources," *Reuters* (Feb. 2, 2018 4:02 AM), https://www reuters.com/article/bon-ton-stores-bankruptcy/bon-ton-stores-clinches-bankruptcy-financing-sources-idUSL2N1PR2BC.

[35] *See* Matt Egan, "Retail Defaults Soar to Record High in 2018," *CNN Business* (Apr. 10, 2018 12:29 PM), https://money.cnn.com/2018/04/10/investing/retail-defaults-sears-moodys/index.html?iid=EL.

[36] *See* Danielle Wiener-Bronner, "Nine West Files for Bankruptcy," *CNN Business* (Apr. 6, 2018 4:19 PM), https://money.cnn.com/2018/04/06/news/companies/nine-west-bankruptcy/index html?iid=EL.

[37] *See* Phil Wahba, "Gymboree Plans to Close After Post-Bankruptcy Comeback Fails," *Fortune*, (Jan. 17, 2019), http://fortune.com/2019/01/17/gymboree-liquidation/; Lauren Thomas, "Gymboree Files for Chapter 11 Bankruptcy; CFO Leaves Retailer," *CNBC* (June 12, 2017 11:42 AM), https://www.cnbc.com/2017/06/12/gymboree-files-for-chapter-11-bankruptcy-cfo-departs-retailer html.

[38] *See* Daniel Keyes, "E-Commerce Will Make Up 17% of All US Retail Sales by 2022 – and One Company Is the Main Reason," *Business Insider* (Aug. 11, 2017 11:12 AM), https://www.businessinsider.com/e-commerce-retail-sales-2022-amazon-2017-8.

[39] *Id.*; UBS, "Q-Series: eCommerce Migration: How Will Penetration Rates Evolve by Category? (Revised)" (Dec. 19, 2018); *See also* FTI Consulting, "2017 U.S. Online Retail Forecast" (Oct. 16, 2017), https://www fticonsulting.com/insights/reports/2017-us-online-retail-forecast; FTI Consulting, "2018 U.S. Online Retail Forecast" (Sept. 10, 2018), https://www fticonsulting.com/insights/articles/2018-us-online-retail-forecast.

where overall U.S. retail sales grow by 3 percent, brick and mortar stores could only expect to achieve annual sales growth of 1 percent.[40]

35. The downturn in Sears's financial performance coincided with the decision by Sears's management to transform Sears into an "asset light" retailer instead of a more traditional brick and mortar retailer. Sears added an online and what is known as an "omni-channel" (or integrated online and offline shopping experience) strategy to better compete with Amazon and other online retailers. However, Sears lagged behind other competitors, like Walmart and Target, who were already moving aggressively online and investing heavily in omni-channel retailing by, for example, implementing buy online, pick up in store, ship to store, ship from store, and return to store options.[41]

36. [redacted] This decline is especially dramatic when considering the growth in the overall U.S. e-commerce market. [redacted]

[40] UBS, *supra* note 39. This projection is also in line with Green Street Advisors's prediction that two-thirds of sales growth will come from the increase in e-commerce over the foreseeable future. *See* Green Street Advisors, LLC, "Retail: Survival of the Fittest."

[41] *See*, *e.g.*, CBInsights, "Surviving the Retail Apocalypse" (2018), pp. 40–46; *see also* Fareeha Ali, "Sears Is Bankrupt: Missed E-Commerce Opportunities and Poor Omnichannel Execution Contributed to Sears' Decline" (Oct. 15, 2018), https://www.digitalcommerce360.com/2018/10/15/sears-files-for-bankruptcy-as-e-commerce-stalled-for-years/.

[42] 2019 Project Transform Business Plan, p. 40 (RS_UCC_00000682 at RS_UCC_00000722); *see also* Ali, *supra* note 41.

Exhibit 6
Historical Sears Online EBITDAP Margin
2010 - 2017

[redacted]

37. The decline of regional malls has also adversely impacted Sears. Industry analysts expect between 20 to 25 percent of all U.S. malls to close between 2017 and 2022.[43] Enclosed malls in the U.S., with the exception of top tier class-A malls, have experienced a decline in traffic and industry experts expect these lower tier malls to continue to deteriorate. Sears, however, divested stores in top tier Class-A malls, including, for example, its stores in the King of Prussia Mall and the Ala Moana Center.[44] As a result, more than 70 percent of the remaining Sears stores are in middle tier (class B and C) malls that

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43 *See* Credit Suisse, "Apparel Retail & Brands: Making Sense of Softlines Following a Tumultuous Twelve Months" (May 2017), pp. 13-14.

44 *See* International Council of Shopping Centers, "Shopping for the Truth: Time Well Spent" (Jan. 24, 2019); Natalie Kostelni, "Sears to Close at King of Prussia Mall," *Phila. Bus. J.* (October 20, 2014 12:54 PM), https://www.bizjournals.com/philadelphia/blog/real-estate/2014/10/sears-to-close-at-king-of-prussia-mall html?s=print; Lauren Thomas, "America's 10 Most Valuable Malls Are Bringing in Billions in Sales. Here's Where They Are," *CNBC* (Jan. 29, 2018 12:02 PM), https://www.cnbc.com/2018/01/29/americas-10-most-valuable-malls-are-bringing-in-billions-in-sales-heres-where-they-are.html; "Sears Closes Ala Moana Center Store in Honolulu," *Pacific Bus. News* (June 3, 2013 12:55 PM), https://www.bizjournals.com/pacific/blog/morning_call/2013/06/sears-closes-ala-moana-center-store-in html.
Sears reopened an Ala Moana location in November 2017; however, the reopened store only features appliances and mattresses. *See* HNN Staff, "Sears Is Back at Ala Moana (But Not Like You Remember It)," *Hawaii News Now* (Nov. 9, 2017 1:23 AM), http://www hawaiinewsnow.com/story/36800809/sears-to-reopen-in-ala-moana-center-after-4-year-hiatus/.

generate less than $500 per square foot of retail space.[45] And as I mention below, Sears, with $150 in sales per square foot, is near the bottom end for the middle tier malls.[46] Industry analysts expect continued problems for malls rated class-B and below given the rapidly changing mall landscape.[47]

38. Based on my professional experience, I would expect Sears, in particular, to encounter challenges given recent changes in the mall landscape. For example, Bon-Ton, as described above, recently closed all of its stores after filing for bankruptcy in February 2018. A high percentage of Sears's remaining brick and mortar stores are in the same malls as Bon-Ton's recent closures, which could further deteriorate these malls and thus further hurt Sears's traffic and sales in these malls.[48]

39. At the same time, Sears continues to face increased competition from other big box retailers such as Home Depot, Lowe's, Target, and Walmart. The proximity of these retailers' stores to Sears's stores increases their direct competition with Sears. Currently, 81 percent of Sears's stores are within five miles of a Home Depot store and 71 percent are within five miles of a Lowe's store.[49] Similarly, 80 percent of Sears's stores are within a fifteen minute drive of a Home Depot, Lowe's, or Best Buy store. [redacted].[50]

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[45] *See* Jennifer Duell Popovec, "Performance Gap Grows within the B Mall Sector," *Nat'l Real Estate Investor* (Nov. 13, 2014), https://www nreionline.com/retail/performance-gap-grows-within-b-mall-sector; Liz Wolf, "Sears Will End Up in Liquidation, Say Experts, Proving a Mixed Blessing for Mall Landlords," *Nat'l Real Estate Investor* (Oct. 18, 2018), https://www.nreionline.com/retail/sears-will-end-liquidation-say-experts-proving-mixed-blessing-mall-landlords.

[46] *See* ISI, "Sears Holdings (SHLD): 'We May Continue to Experience Challenges in our Financial Performance…'" (Aug. 21, 2014), p. 10.

[47] *See* Laura Sanicola, "America's Malls Are Rotting Away," *CNN Business* (Dec. 12, 2017 8:12 PM), https://money.cnn.com/2017/12/12/news/companies/mall-closing/index html.

[48] *See* Credit Suisse, "US Store Closures Monitor: 2018 on Track for Another Peak Square Footage Closure Year" (Apr. 23, 2018), p. 6.

[49] *See* Kevin Curran, "Chart of the Day: Home Depot and Lowe's Go Head to Head in Home Improvement," *Real Money* (Nov. 12, 2018 2:37 PM), https://realmoney.thestreet.com/investing/stocks/chart-of-the-day-home-depot-and-lowes-go-head-to-head-in-home-improvement-14777735.

[50] *See* 2019 Project Transform Business Plan, p. 6 (RS_UCC_00000682 at RS_UCC_00000688); Edmund Mander, "Best Buy, Home Depot, Lowe's Have Most to Gain from Sears Closures, Study Finds," *Int'l Council of Shopping Ctrs.* (2019), https://www.icsc.org/news-and-views/icsc-exchange/home-depot-lowes-best-buy-gain-most-from-sears-closures-study-finds.

40. Similarly, Sears's apparel business has faced strong competition from other retailers. For example, according to industry analysts, over 25 percent of surveyed U.S. internet users had purchased apparel from Walmart, Amazon, Target, and Kohl's as of January 2018. In comparison, only 6.7 percent and 6.1 percent of users had purchased apparel from Sears and Kmart, respectively.[51]

ii. Sears Underinvested in Key Aspects of the Business

41. Traditional retailers like Sears need to invest in their brick and mortar stores and back-office systems to keep the stores and systems "up-to-date" and to satisfy the customer experience. Moreover, retailers like Sears also need to invest significant resources in online platforms to capture the growing e-commerce market. In my opinion, based on my professional experience and review of the case materials, Sears's management under ESL's ownership failed to adequately invest in these critical aspects of the business. These failures further exacerbated the industry-wide challenges described earlier.

42. First, as part of my regular visits to both mall-based locations of Sears and off-mall locations of Kmart, I would judge Sears stores as among the least attractive mall anchors, and Kmart stores as outdated. In my opinion, the physical appearance of these stores, which directly affects the consumer experience and therefore store sales, shows signs of insufficient maintenance capital expenditures and is inferior to that of Target and Walmart stores. I further note that Walmart has also aggressively scaled up its online business to capture industry trends, with its online sales projected to increase from $11 billion in 2017 to $42 billion by 2022.[52]

43. I evaluated Sears's capital expenditures, which further support my assessment that Sears has failed to make the capital investments required to succeed in the rapidly changing retail industry. In 2018, Sears's net capital expenditures ("CapEx") as a percentage of total sales was 0.5 percent, which is far below the retail industry average of 1.7 percent.[53]

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[51] *See* Krista Garcia, "The State of US Apparel in Five Charts," *eMarketer Retail* (Apr. 27, 2018), https://retail.emarketer.com/article/state-of-us-apparel-shopping-five-charts/5ae2106bebd4000b78fe1517.

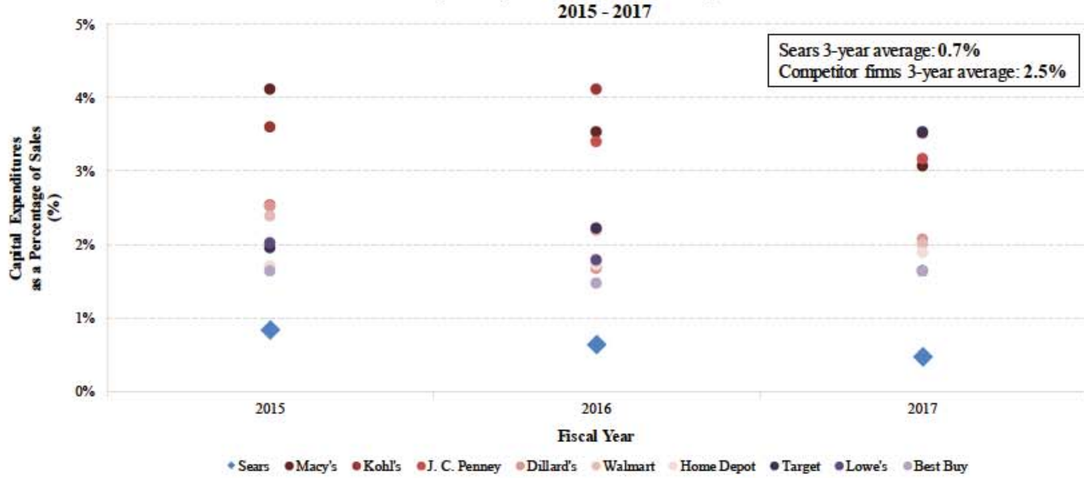
[52] *See* FTI Consulting, "2017 U.S. Online Retail Forecast" (Oct. 16, 2017), p. 3.

[53] *See* Aswath Damodaran, NYU Stern, "Capital Expenditures by Sector (US)," http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/capex.html (last visited Jan. 26, 2019); Sears Holdings Corp., 2017 Form 10-K, filed Mar. 23, 2018, p. 25.

On a per square foot of retail space basis, Sears's CapEx spending in 2017 was as low as 91 cents, while one of Sears's main appliance competitors, Best Buy, invested $15.36 of CapEx per square foot, higher by a factor of 16.9.[54]

44. I also evaluated Sears's CapEx relative to the CapEx of comparable firms. Exhibit 7 compares Sears's CapEx as a percent of sales to the same figure for the firms listed as comparable in the combination of analyst reports, Thomson, and Capital IQ. Between 2015 and 2017, as shown, Sears had the lowest CapEx relative to sales within this group, indicating that Sears severely underinvested in its business compared to its competitors. For Sears, the average capital expenditure as a percentage of sales was 0.7 percent, whereas the average of this measure for its comparable companies was 2.5 percent.

Exhibit 7
Comparison of Sears and Select Competitors
Capital Expenditures as a Percentage of Sales
2015 - 2017



45. Similarly, Exhibit 8 shows that Sears's total marketing spending per store has declined in recent years. [redacted][55]

[54] *See* Nathan Bomey & Charisse Jones, "Sears, Kmart Stores Ailing as CEO Eddie Lampert's Hedge Fund Gets Hundreds of Millions," *USA Today* (June 18, 2018 1:50 PM), https://www.usatoday.com/story/money/2018/06/18/sears-ceo-eddie-lampert-kmart/638218002/.

[55] *See* ESL Investments, "Lender Presentation" (ESL-UCC-00004499); *see also* Kamlani Dep., p. 150.

Exhibit 8
Total Marketing Expense per Store
2010 - 2017

[redacted]

46. These numbers are consistent with my experience and view that Sears has failed to invest in making its stores an attractive shopping experience for the consumer. Such chronic underinvestment has resulted in Sears stores losing their attractiveness. Sales per square foot for Sears stores was $154 in 2014, well below the figures for comparable companies like Kohl's ($229), Macy's ($189), Walmart ($432), or Home Depot ($350).[56] By suppressing such critical investments, Sears has limited its ability to compete.

iii. ESL Divested Sears's Assets Instead of Investing in the Business

47. Over the past decade and under ESL's control, Sears's strategy has focused on divesting assets as opposed to investing in critical aspects of the business. Amidst Sears's further financial erosion over the past five years, it has increasingly relied on asset sales to generate cash needed to satisfy its obligations and short-term cash needs.[57] Industry analysts have commented on this pattern. For example, in April 2018, an analyst report stated that Sears "has consistently divested assets over the past five years with no

[56] ISI, *supra* note 46, p. 10.

[57] This is relevant to my later assessment of the Plan, as ESL's past strategic choices regarding Sears further highlights the speculative nature of the Plan's forecasts and casts doubt on their feasibility.

apparent improvement in fundamental operations."[58] The report further observed that "[Mr.] Lampert appears to have become overconfident in his ability to turn around two struggling retailers, which was particularly challenging in the current retailing downdraft" and instead "has had much more success in realizing asset values than in operating retail stores."[59]

48. Several major transactions highlight Sears's pattern of divesting important assets from its business:

- In April 2014, Sears Holdings spun off the Lands' End brand for $500 million, significantly less than the $2 billion that Sears paid for the brand in 2002.

- In July 2015, Sears Holdings completed a sale-leaseback deal with Seritage Growth Properties, a newly formed real estate investment trust owned by Mr. Lampert and other shareholders. The deal generated $2.7 billion in cash for Sears, in exchange for 235 Sears and Kmart stores and a 50 percent stake in another 31 Sears properties jointly held with other real estate investors.[60] Retail analysts described these properties as the company's "last large monetizable asset" and as "the best [properties] in [the company's] portfolio," located in areas with higher population densities and income levels.[61] The remaining properties, they said, were "likely more of a liability than an asset."[62]

- In January 2017, Sears sold its Craftsman tool brand to Stanley Black & Decker, which provided Sears with an immediate cash injection of $525 million. Sears valued the deal at $900 million, including future promised cash flows.[63]

49. In my opinion, Sears's decision to sell Craftsman, which was an iconic tool brand that had been with Sears for 90 years, damaged Sears's potential to improve its market share. Moreover, the deal ended up creating additional competition after Lowe's struck a deal in

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58 Susquehanna Financial Group, "Sears Holdings: Chairman Lampert Sends (and Receives) Break-Up Letter" (Apr. 23, 2018) [hereinafter Susquehanna Financial Group, Lampert Break-Up Letter], pp. 1-2.

59 *Id.*

60 *See* Press Release, Sears Holdings Corp., "Sears Holdings Completes Seritage Growth Properties Transaction" (July 7, 2015).

61 Evercore ISI, "Sears Holdings (SHLD): Seritage Update" (June 3, 2015), p. 1.

62 *Id.*

63 Paul R. La Monica, "Sears Sells Craftsman to Stanley Black & Decker," *CNN Business* (Jan. 5, 2017 2:33 PM), https://money.cnn.com/2017/01/05/investing/sears-sells-craftsman-stanley-black-decker/index html.

fall 2017 to start selling Craftsman tools in its stores.[64] More generally, the above transactions simply provided cash that ultimately only delayed the Company's collapse. This opinion is consistent with remarks I made on CNBC's *Nightly Business Report* in 2017, following Sears's sale of the Craftsman tool brand:

> [O]nce you do some asset sales, you can go a little longer.… [But] basically they're selling the assets, they're taking the cash, they're putting it in the fireplace, and they're sending it up the chimney, because they keep losing so much money every quarter."[65]

50. My 2017 commentary is consistent with that offered by an industry analyst in April 2017:

> The primary concern here is that as SHLD attempts to get ahead of its sales decline and FCF burn by cost cutting, as the organization has shrunk, the operating results have gotten worse rather than better. Cuts to advertising, the cumulative effect of losing half of its Kmart stores and 28% of Full-line Sears in a decade, and persistent organizational headcount reduction are clearly shrinking customer mindshare and accelerating the decline in SHLD relevance. Without a stabilization of the topline, which we see no indication of occurring, SHLD will likely continue this downtrend. We expected a continuation of the vicious cycle SHLD has been caught in for the last 5 years where its sales and operating losses lead to closures and cost cutting insufficient to offset the sales decline. This will then require more asset sales and/or asset secured debt deals, but with the sales still shrinking the cycle repeats.[66]

iv. Sears's Past Initiatives Have Been Unsuccessful and Based on Unrealistic Plans

51. [redacted]

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64 Chris Isidore, "Sears' Iconic Craftsman Tools Coming to Rival Lowe's," *CNN Business* (Oct., 24, 2017 1:25 PM), https://money.cnn.com/2017/10/24/news/companies/craftsman-lowes-sears/index.html.

65 NBR Staff, "Nightly Business Report – January 5, 2017," *NBR*, http://nbr.com/2017/01/05/nightly-business-report-january-5-2017/.

66 Evercore ISI, "The Vicious Cycle Down" (Apr. 24, 2017), p. 1.

67 *See, e.g.*, Sears Holdings Corp., 2015 Plan Review, Jan. 21, 2015 (RS_SHC_00015574); Sears Holdings Corp., 2016 Plan Update, Jan. 28, 2016 (Sears_ESL00012719); Sears Holdings Corp., 2017 Plan Update, Feb. 8, 2017 (Sears_ESL00015417).

[redacted]

Exhibit 9
Overview of Sears Initiatives Outlined in Management Plans and 2019 ESL Business Plan
2013 - 2019

	Management Plans						
Initiatives	2013	2014	2015	2016	2017	2018	2019 ESL Business Plan
[redacted]							

52. [redacted]

68 *See, for example,* Sears Holdings Corp., 2014 Plan Review, Jan. 22, 2014 (DUFF00045570).

69 *See* Sears Holdings Corp., 2014 Plan Review, Jan. 22, 2014 (DUFF00045570); Sears Holdings Corp., 2015 Plan Review, Jan. 21, 2015 (RS_SHC_00015574); Sears Holdings Corp., 2016 Plan Update, Jan. 28, 2016 (Sears_ESL00012719); Sears Holdings Corp., 2017 Plan Update, Feb. 8, 2017 (Sears_ESL00015417); 2019 Project Transform Business Plan (RS_UCC_00000682).

70 *See* Interview of Edward Lampert, *In re: Sears Holdings Corp., et al.*, (Dec. 12, 2018) [hereinafter "Lampert Interview Transcript"], p. 255; *See also* Interview of Robert Riecker, *In re: Sears Holdings*

[redacted]

53. [redacted]

Corp., et al., (Dec. 5, 2018) [hereinafter "Riecker Interview Transcript"], p. 46; Interview of Naren Sinha, *In re: Sears Holdings Corp., et al.*, (Dec. 4, 2018) [hereinafter "Sinha Interview Transcript"], pp. 23-26.

71 *See* Interview of Robert Schriesheim, *In re: Sears Holdings Corp., et al.*, (Dec. 19, 2018) [hereinafter "Schriesheim Interview Transcript"], pp. 40–44; Sinha Interview Transcript, p. 26.

72 Schriesheim Interview Transcript, pp. 64–65.

73 *See* Schriesheim Interview Transcript, pp. 48–50.

74 Sears Holdings Corp., 2018 Plan Review, Jan. 30, 2018, p. 7 (Sears_ESL00020007 at Sears_ESL00020007_007).

75 Sears Holdings Corp., 2018 Plan Review, Jan. 30, 2018, p. 8 (Sears_ESL00020007 at Sears_ESL00020007_008).

[redacted]

54. [redacted]

55. In my opinion, it is sensible for retail industry executives and managers to develop a "bottom-up" business plan based on input from employees close to the business. It is also sensible for management to add stretch targets to incentivize business divisions to achieve better results than the conservative estimates that employees close to the business are likely to propose. However, Sears's management, under ESL's control and ownership, undermined the integrity and reliability of its target setting by adjusting the

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76 Sears Holdings Corp., 2017 Plan Update, Feb. 8, 2017, p. 5 (Sears_ESL00015417 at Sears_ESL00015417_005).

77 Sears Holdings Corp., 2015 Plan Review, Jan. 21, 2015, p. 3 (RS_SHC_00015574 at RS_SHC_00015577).

78 Sears Holdings Corp., 2015 Plan Review, Jan. 21, 2015, p. 47 (RS_SHC_00015574 at RS_SHC_00015621).

79 [redacted] *See* Sears Holdings Corp., 2015 Plan Review, Jan. 21, 2015, pp. 36-45 (RS_SHC_00015574 at RS_SHC_00015610-19).

80 [redacted] *See* Sears Holdings Corp., 2015 Plan Review, Jan. 21, 2015, pp. 36-45 (RS_SHC_00015574 at RS_SHC_00015610-19).

bottoms-up targets with large, unexplained, and persistent gaps to achieve more optimistic leadership-driven targets. Given its approach, I am not surprised that Sears consistently failed to meet its plans.

56. [redacted]

Exhibit 10
Comparison of Sears Actual and Planned Total Revenue
2010 - 2017

[redacted]

57. Exhibit 11 compares Sears's actual and targeted gross margin. [redacted]

Exhibit 11
Comparison of Sears Actual and Planned Gross Margin
2010 - 2017

[redacted]

58. Exhibit 12 compares Sears's actual and targeted EBITDAP. [redacted]

Exhibit 12
Comparison of Sears Actual and Planned EBITDAP
2010 - 2017

[redacted]

59. In addition to revenue-driving initiatives, Sears has attempted to improve its declining financial performance through cost reductions and store closure targets, as described earlier. [redacted]

60. Similarly, as discussed earlier, Sears's store count has declined more than 87 percent from its peak of over 4,000 stores in 2010 to 505 stores as of year-end 2018. These store closures, however, failed to stem, let alone reverse, the decline in the business. Exhibit 13 shows the average store-level EBITDAP margin for the 425 stores that contemplates retaining. [redacted] which is further

81 ESL Investments, "Lender Presentation" (ESL-UCC-00004499).

evidence that Sears's financial problems are not isolated to a handful of stores, but are widespread.

Exhibit 13
Historical EBITDAP Margins for 425 Go-Forward Sears Stores in 2019 ESL Business Plan

[redacted]

61. [redacted].

IV. ESL's Initiatives and Financial Projections for a Post-Bankruptcy Sears Are Overly Optimistic and Unreasonable

62. In January 2019, ESL presented the 2019 ESL Business Plan for Sears's post-bankruptcy operations.[82] [redacted][83] In this section, I provide the basis for my conclusion that ESL's financial projections are speculative, overly optimistic, and unreasonable. ESL's projections and initiatives contained in the Plan are not, in my opinion, sufficient to reverse Sears's longstanding downward trend and reinforcing cycle of asset divestures and underinvestment in remaining businesses. [redacted]

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82 *See* 2019 Project Transform Business Plan (RS_UCC_00000682).

83 *See* 2019 Project Transform Business Plan (RS_UCC_00000682).

[redacted] Given its historical record and the fact that [redacted], in my opinion, it is more reasonable to expect that a going-forward Sears would close stores, sell assets, lay off employees, and shrink its business.

A. Overview of the 2019 ESL Business Plan

63. From a financial forecasting perspective, the 2019 ESL Business Plan [redacted] In this section, I discuss these strategic plans and underlying assumptions in more detail.

64. [redacted].[84]

65. [redacted]

[84] *See* 2019 Project Transform Business Plan, pp. 5 and 46 (RS_UCC_00000682 at RS_UCC_00000686 and RS_UCC_00000728).

[85] *See* 2019 Project Transform Liquidity Analysis, pp. 2-3 (ESL-UCC-00005178 at ESL-UCC-00005180-181). [redacted]

[redacted]

66. [redacted]

B. [redacted]

67. [redacted] In the specific case of Sears, the lack of a strong CEO makes it even more implausible that the Company will [redacted], particularly given the long history of negative EBITDAP results.[91]

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86 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180).

87 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180). [redacted]

88 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180).

89 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180).

90 *See* 2019 Project Transform Liquidity Analysis, p. 4 (ESL-UCC-00005178 at ESL-UCC-00005182).

91 *See* Exhibit 2.

Exhibit 14
Comparison of Sears Prior EBITDAP to Forecasted EBITDAP in the 2019 ESL Business Plan
2015 - 2021

[redacted]

68. I describe below why several of the underlying assumptions included in the financial forecasts are unreliable, given their obvious diversion from historical trends despite the significant challenges facing Sears. That said, even if one assumes that these speculative and unreasonable assumptions are somehow achievable [redacted]

Exhibit 15
Sears Business Unit EBITDAP Margin before Deducting Corporate SG&A and Other Adjustments
2015 - 2021

[redacted]

C. [redacted]

69. [redacted] As I described earlier, Sears has been cutting costs for years, without achieving either top or bottom-line success. [redacted] For example, the Plan forecasts:

- [redacted]

- [redacted]

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92 *See* Exhibit 9 for an overview of cost initiatives outlined in Sears's management plans for prior years; *see also* 2019 Project Transform Business Plan, p. 46 (RS_UCC_00000682 at RS_UCC_00000728).

93 *See* 2019 Project Transform Business Plan, p. 46 (RS_UCC_00000682 at RS_UCC_00000728); *see also* Sears Holdings Corp., Lender Presentation, Jan. 24, 2019, pp. 27, 29.

94 *See* 2019 Project Transform Liquidity Analysis, p. 4 (ESL-UCC-00005178 at ESL-UCC-00005182).

[redacted] [95]

70. In my experience, reductions in SG&A expenses are not easy to achieve. [redacted] distribution centers tend to be set up as a "door for store" arrangement or in a product arrangement, and sometimes as both.[97] [redacted] When a distribution center has to be rearranged to handle a different configuration of products and a different number of stores, all while serving a new geography, there are inevitably disruptions and temporary cost and distribution issues. For example, in 2006, when Stage Stores, a department store operator, reoriented its distribution centers into north and south and merely shifted stores between centers for future efficiencies, I recall that the temporary dislocations were larger than anticipated and large enough to merit discussion with the financial community.

71. While retail companies annually reevaluate their SG&A expenditures and seek to improve the allocation of those expenditures, dramatic reductions in SG&A expenditures or SG&A as a percentage of sales are highly likely to, at least in the near term, adversely impact sales and gross margins. Retailers generally only attempt SG&A expense reductions [redacted] when they are restructuring a business and are prepared for at least one or two years of negative revenue

95 *See* 2019 Project Transform Business Plan, p. 49 (RS_UCC_00000682 at RS_UCC_00000731).

96 *See* Sears Holdings Corp., 2018 Plan Review, Jan. 30, 2018, pp. 7, 19 (Sears_ESL00020007 at Sears_ESL00020007_007, _019); 2019 Project Transform Business Plan, p. 33 (RS_UCC_00000682 at RS_UCC_00000715); 2019 Project Transform Liquidity Analysis, p. 4 (ESL-UCC-00005178 at ESL-UCC-00005182); Sears Holdings Corp., Supply Chain Transformation, Nov. 14, 2018, p. 4. [redacted] *See* 2019 Project Transform Business Plan, p. 47 (RS_UCC_00000682 at RS_UCC_00000729).

97 "Door for store" distribution centers have dedicated distribution capacity for every store that they serve. Product arrangement distribution centers are focused on distributing specific products.

growth given the expected fundamental changes in their business model. These restructuring efforts and SG&A expense reductions are frequently accompanied by one or two years of declining gross margins given the changing merchandise mix or relationship with the customer base. In **Appendix C**, I describe selected case studies of restructurings in the retail industry that highlight how revenue and margins can deteriorate in the aftermath of significant cost reductions. Lastly, even when a retailer successfully achieves targeted SG&A expense reductions, these reductions generally increase the risk that the resulting declines in sales and gross margins necessitate further reductions in SG&A.[98] That is, the reductions increase the risk of a cycle of reductions, declining profitability, and further reductions. Indeed, as explained in Section III, Sears has historically implemented several cost cutting initiatives and yet continued to face declining top and bottom-line results.

D. The Revenue Forecasts Ignore Recent Trends and Are Not Achievable

72. [redacted].[99] [redacted]

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98 *See* 2019 Project Transform Liquidity Analysis, p. 5 (ESL-UCC-00005178 at ESL-UCC-00005183).

99 *See* 2019 Project Transform Business Plan, p. 14 (RS_UCC_00000682 at RS_UCC_00000696).

100 *See* Chris Isidore, "Sears, the Store that Changed America, Declares Bankruptcy," *CNN Business* (Oct. 15, 2018 12:58 PM), https://www.cnn.com/2018/10/15/business/sears-bankruptcy/index html; *see also* Sears Holdings Corp., Preliminary Business Plan, December 2018, p. 4.

Exhibit 16
Sears Actual and Planned Revenues by Business Units
2015 - 2021

[redacted]

73. [redacted]

Exhibit 17
Historical Average Sales per Store for 425 Go-Forward Sears Stores in 2019 ESL Business Plan
2010 - 2018

[redacted]

74. [redacted].

Exhibit 18
Same Store Sales Growth for 425 Go-Forward Sears Stores in 2019 ESL Business Plan
2011 - 2018

[redacted]

75. [redacted][102]

Exhibit 19
Year-over-Year Change in Same Store Monthly Sales for 425 Go-Forward Sears Stores in 2019 ESL Business Plan
February 2018 - December 2019

[redacted]

76. In my opinion and based on my experience, there are fundamental flaws in such an approach that further render the assumption unreliable. [redacted] Therefore,

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101 2019 Project Transform Business Plan, p. 4 (RS_UCC_00000682 at RS_UCC_00000686).

102 *See* 2019 Project Transform Business Plan, p. 4 (RS_UCC_00000682 at RS_UCC_00000686).

the observed measure in a single month cannot reliably establish a basis for assuming [redacted] Therefore, even if one were to use these data to inform an assumption about expected same-store sale performance, one would need to account for the possibility that same-store sales early in the year would be worse than those later in the year.

77. [redacted] In the retail industry, this is a trade-off that can happen. For example, a retailer may decide to lower prices in order to move inventory in advance of a change of seasons. However, [redacted]

78. [redacted] These growth assumptions are [redacted] and further unrealistic given the industry trends and headwinds facing the business.

79. In addition, approximately half of the Sears business comes from the Kmart legacy stores, which will have to achieve the planned revenue increases against competitors

103 [redacted]

including Walmart and Target. In 2018, Walmart and Target increased store traffic and, in some quarters, achieved 40 percent growth in online sales.[104]

80. [redacted][105] This assumption appears reasonable given the continued erosion in store performance and the fact that Sears reduced its number of stores from 4,000 to the currently proposed 425 stores.[106] Based on my experience, even with a dramatically reduced footprint, the remaining Sears stores could not stabilize the business and achieve same-store sales growth. [redacted] Sears would not be able to operate profitably with its current infrastructure.

81. [redacted][108] Exhibit 20 shows the actual revenue, gross margin, and EBITDAP for these other units from 2015 through 2017 and expected performance for these units according to the Plan.

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104 *See* Thomson Reuters, "Edited Transcript: TGT – Q2 2018 Target Corp Earnings Call" (Aug. 22, 2018 12:00 PM), p. 8; Thomson Reuters, "Edited Transcript: Q3 2018 Target Corp Earnings Call" (Nov. 20, 2018 1:00 PM), p. 3; *see also* Walmart, "Walmart U.S. Q3 Comp Sales(1) Grew 3.4% and Walmart U.S. eCommerce Sales Grew 43%, Q3 GAAP EPS of $0.58" (Nov. 15, 2018); Walmart, "Walmart U.S. Q2 Comps(1) Grew 4.5% and Walmart U.S. eCommerce Sales Grew 40%, Q2 GAAP Net Loss Per Share of $0.29; Adjusted EPS(2) of $1.29" (Aug. 16, 2018).

105 *See* 2019 Project Transform Liquidity Analysis, p. 6 (ESL-UCC-00005178 at ESL-UCC-00005184).

106 *See* Exhibit 1. *See also* 2019 Project Transform Business Plan, p. 4 (RS_UCC_00000682 at RS_UCC_00000685).

107 *See* 2019 Project Transform Liquidity Analysis, p. 5 (ESL-UCC-00005178 at ESL-UCC-00005183).

108 *See* 2019 Project Transform Liquidity Analysis, p. 6 (ESL-UCC-00005178 at ESL-UCC-00005184).

Exhibit 20
Performance by Business Unit
2015 - 2021

[redacted]

82. [redacted]

> [redacted][109]

83. [redacted]

[109] *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180).

84. [redacted]

85. [redacted].[116] The speculative nature of the [redacted] is highlighted by the fact that even successful department stores with stable businesses like Kohl's and Macy's barely recognized sales gains in 2018, despite strong consumer spending. Current market

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110 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180).

111 *See* Deposition of Robert Riecker, *In re: Sears Holdings Corp., et al.*, Rough Transcript (Jan. 25, 2019) [hereinafter "Riecker Dep."], p. 122.

112 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180). [redacted]

113 *See* 2019 Project Transform Liquidity Analysis, p. 4 (ESL-UCC-00005178 at ESL-UCC-00005182).

114 *See* Riecker Dep., p. 150.

115 *See* 2019 Project Transform Business Plan, p. 23 (RS_UCC_00000682 at RS_UCC_00000705).

116 *See* Exhibit 16.

sentiment is that consumer spending in 2019 will fall short of 2018, creating yet more risk to what are already [redacted][117]

86. Based on my experience in the industry, prior knowledge of Sears, and review of materials in this case, a more reasonable consolidated revenue forecast for 2019 for Sears would be a decline of 5.5 percent, matching the average same-store sales growth for the 425 go-forward stores over the period of 2011 to 2017.

E. [redacted] Is Not Reliable and Fundamentally Flawed

87. [redacted]

88. [redacted]

89. Based on my experience in the retail industry, these are unrealistic [redacted] As discussed in Section III, Sears has a history of preparing overly optimistic business plans that include large, unexplained, and persistent plugs and "go-gets." [redacted] I also note that, in my professional experience, unrealistic plans are generally

117 *See* Lauren Thomas, "Doom and Gloom: Department Stores' Disappointing Holiday Sales Results Spell Trouble for 2019," *CNBC* (Jan. 17, 2019 7:06 PM), https://www.cnbc.com/2019/01/17/department-stores-disappointing-holiday-sales-results-spell-trouble html/.

118 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180).

119 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180).

counterproductive, as they demotivate employees, especially managers with compensations tied to the targets.

90. Reversing the historical trends, [redacted] will all be extremely difficult to achieve, especially at the present moment. In the retail industry, there is a natural counter balance in pushing for growth in sales and pushing for increases in gross margins. A retailer can lower prices and drive sales, but the retailer would give up its gross margins in the process. Conversely, a retailer can be much more conservative on inventory, give up sales by reducing markdowns, and enhance gross margins. Changing the trajectory of both sales and the gross margins in a short window of time, [redacted] is rare and unusual and requires a significant alteration in the way a company runs its business. [redacted]

91. In conclusion, based on my experience in the industry, prior knowledge of Sears, and review of materials in this case, a more reasonable consolidated gross margin forecast for 2019 for Sears would be no improvement to gross margins, [redacted]

F. The 2019 ESL Business Plan Is Not Transformative and Does Not Justify the Reversal in Financial Trends

92. Achieving the ambitious goals of the 2019 ESL Business Plan requires transformative changes and innovative leadership, [redacted].[120]

i. [redacted]

93. [redacted] Based on my experience in the retail industry, finding a

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[120] *See* Susquehanna Financial Group, Lampert Break-Up Letter, *supra* note 58.

[121] *See* 2019 Project Transform Business Plan, p. 5 (RS_UCC_00000682 at RS_UCC_00000687).

[122] [redacted]. *See* Kamlani Dep., pp. 127-128.

qualified executive to be CEO at a struggling brick and mortar retailer in the current retail environment would be a challenge, and finding one who could turn around Sears consistent with the Plan would be even harder. [redacted]

94. Further, given that post-bankruptcy Sears would remain controlled and owned by ESL, a new CEO, even one afforded independence, would face extraordinary challenges in executing any transformative initiatives in the short time period the Plan provides. In other words, a new CEO would inherit the losing proposition of overly optimistic projections and timelines, combined with legacy ownership and control entities. In my opinion and based on my experience, it will be extremely difficult to find someone who is comfortable leading such a massive transformation under the same ownership structure that managed Sears

.[124]

95. [redacted] My expectation, based on my experience and given Sears's current state, is

123 Interview of Kunal Kamlani, *In re: Sears Holdings Corp., et al.* (Dec. 6, 2018), p. 66.

124 *See* Exhibits 1 and 2; *see also,* 2019 Project Transform Liquidity Analysis, p. 5 (ESL-UCC-00005178 at ESL-UCC-00005183).

125 [redacted] If true, the diversity of job skills required across these different units is yet another reason why finding the right CEO will be difficult.

126 *See* 2019 Project Transform Business Plan, pp. 21, 27, and 31 (RS_UCC_00000682 at RS_UCC_00000703, RS_UCC_00000709, RS_UCC_00000713).

that a post-bankruptcy Sears likely faces significant challenges filling these job openings as well.

ii. [redacted]

96. [redacted]

97. The SYW loyalty program is a useful example of a longstanding initiative at Sears that failed to achieve its intended objectives [redacted] As early as July 2015, Standard & Poor's reported, "[w]e do not assume a significant improvement from the opportunity to substitute traditional promotion dollars with Shop Your Way points."[128] There has been little interest in SYW from industry analysts after 2015.

98. Analysts' lack of interest in the program is consistent with trends in SYW membership. Exhibit 21 shows SYW active membership over the past several years.[129] [redacted]

[127] *See* 2019 Project Transform Business Plan, p. 46 (RS_UCC_00000682 at RS_UCC_00000728).

[128] Standard & Poor's Ratings Services, "Sears Holdings Corp. 'CCC+' Rating Affirmed; Second-Lien And Senior Note Ratings Raised On Recovery Prospects," July 1, 2015, p. 3.

[129] *See* Interview of Kunal Kamlani, *In re: Sears Holdings Corp., et al.* (Dec. 6, 2018), p. 63.

[130] *See id.*

Exhibit 21
Shop Your Way Active Membership
2012 - 2017

[redacted]

99. [redacted] In my opinion, these claims are unrealistic given that Sears initiated SYW approximately ten years ago and the program has still not achieved its promise. [redacted]

[131] *See* 2019 Project Transform Business Plan, p. 9 (RS_UCC_00000682 at RS_UCC_00000691).

[132] *See* 2019 Project Transform Business Plan, pp. 12 and 35 (RS_UCC_00000682 at RS_UCC_00000694, RS_UCC_00000717).

[133] *See* 2019 Project Transform Business Plan, p. 40 (RS_UCC_00000682 at RS_UCC_00000722).

[134] *See* 2019 Project Transform Business Plan, p. 9 (RS_UCC_00000682 at RS_UCC_00000691).

100. [redacted]

101. [redacted] In its 2010 10-K filing, Sears stated:

> Our ***existing store base*** is a significant asset, as our 4,000 stores provide us with a physical presence in almost all major communities in the United States and Canada. We have been working to improve our existing stores in a number of ways. First and foremost, we are using technology to transform our store experiences and we continue to innovate as an integrated retailer, offering our customers a seamless experience across channels under the Shop Your Way banner.[136]

102. Second, the value of the program to partners is substantially lower today than in the past. The [redacted] declining number of retail stores and customers visiting those stores devalues the overall value of the program.

103. Third, in my opinion, the fact that Sears entered bankruptcy is likely insufficient to qualm potential partners' concerns regarding Sears's financial viability going forward. [redacted] in my opinion, many potential partners will likely want to see Sears actually achieve its operational and financial goals before entering into a business

---

[135] Kamlani Dep., pp. 144-145.

[136] Sears Holdings Corp., 2010 Form 10-K, filed Mar. 11, 2011 (emphasis in original), pp. 19-20. The programs are described as, "We launched our Shop Your Way Rewards program late in 2009 and continued to grow membership and capabilities in 2010. The Shop Your Way Rewards program is intended to transition Sears Holdings from serving customers to building relationships with members. We believe that Shop Your Way Rewards will allow us to learn more about our individual customers and therefore position us to better meet their needs. The Shop Your Way Rewards program will also enhance our ability to communicate with customers digitally. Such digital communication tools present a new opportunity to personalize our messages and make them more individually relevant." *Id.*, p. 20.

relationship with the Company. [redacted]

104. In summary, the SYW program failed to reverse Sears's downward trend during the nearly one decade of the loyalty program's existence. [redacted]

iii. The [redacted] Are Minor and Speculative

105. [redacted]

106. [redacted]

107. Other assumptions made by ESL in the 2019 ESL Business Plan are also questionable. [redacted]

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137 *See* 2019 Project Transform Business Plan, p. 21 (RS_UCC_00000682 at RS_UCC_00000703).

138 *See* 2019 Project Transform Business Plan, p. 27 (RS_UCC_00000682 at RS_UCC_00000709).

139 *See* 2019 Project Transform Business Plan, p. 31 (RS_UCC_00000682 at RS_UCC_00000713).

140 *See* 2019 Project Transform Business Plan, pp. 37-38 (RS_UCC_00000682 at RS_UCC_00000719-20).

141 *See* 2019 Project Transform Business Plan, p. 18 (RS_UCC_00000682 at RS_UCC_00000700).

142 *See* 2019 Project Transform Liquidity Analysis, p. 2 (ESL-UCC-00005178 at ESL-UCC-00005180).

[redacted]

G. [redacted] Is Speculative

108. Days Payable Outstanding ("DPO") measures the average number of days a company takes to pay its suppliers. From a company's perspective, an increase in DPO is an improvement in this particular efficiency measure and a decrease is a deterioration. [redacted]

109. [redacted]

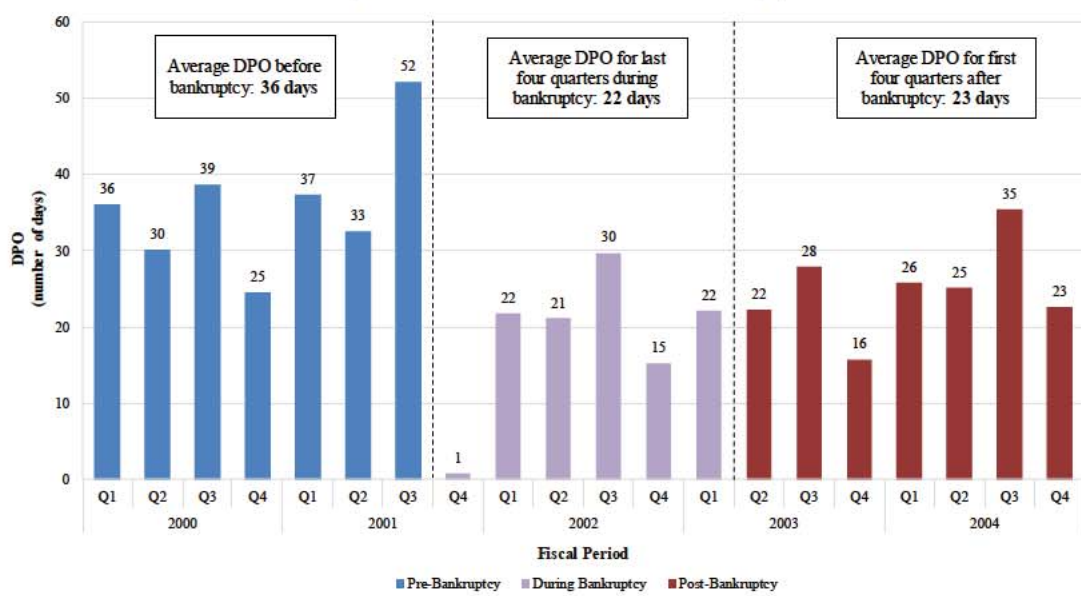
[143] *See* 2019 Project Transform Liquidity Analysis, p. 3 (ESL-UCC-00005178 at ESL-UCC-00005181).

Exhibit 22
Comparison of Actual and Planned Sears Days Payable Outstanding ("DPO")

[redacted]

110. [redacted] Exhibit 23 shows that, during the last four quarters of the bankruptcy proceedings, Kmart's DPO was 22 days. After emerging from bankruptcy, its average DPO in the four quarters after the bankruptcy was essentially unchanged at 23 days, and did not recover to its pre-bankruptcy level.

Exhibit 23
Comparison of Kmart DPO Before and After Bankruptcy



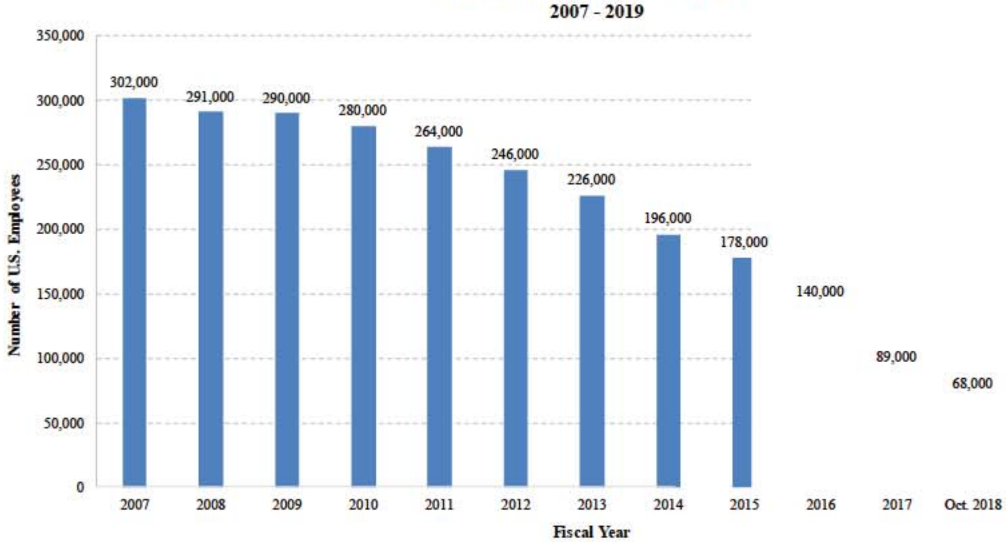
111. In my professional experience, vendors will want to see improvement in Sears's financial and business performance before extending credit terms. Without building up a track

record of observed performance, it is unlikely that Sears could [redacted] A more realistic, but still optimistic assumption would be that it could return to, but not exceed, its pre-bankruptcy levels by the end of 2019.

H. ESL's [redacted] Cannot Be Sustained

112. In my opinion, if Sears continues to operate under the same ownership with an operating plan that [redacted], Sears is unlikely to materially improve. This means that its employees will continue to face the high risk of job loss. As described in prior sections, Sears's track record includes many years of consistently optimistic targets, failed targets, store closures, and ultimately job reductions. As shown in Exhibit 24, the number of U.S. Sears employees has declined from 302,000 in 2007 to 68,000 as of October 2018. [redacted]

Exhibit 24
Total Number of U.S. Sears Employees
2007 - 2019



144 *See* 2019 Project Transform Liquidity Analysis, p. 7 (ESL-UCC-00005178 at ESL-UCC-00005184).

J R Kniffen

Jan R. Kniffen
January 26, 2019

Exhibit 1
Sears Historical Total Revenue and Total Number of Sears Stores
2010 - 2018

[redacted]

Notes:
[1] Fiscal years 2010 through 2013 include stores operated by the Sears Canada business segment. This segment was excluded from the Sears 10-K beginning in 2014 following the de-consolidation of Sears Canada.
[2] The total number of Sears stores as of 2018 is sourced from the 2019 Liquidity Analysis due to the fact that the Sears 10-K for fiscal year 2018 is not yet available.
[3] Sears's fiscal year begins in February.

Sources:
[1] Sears Holdings Corp., *VFS Act Vs Plan 2010-18.xlsx*.
[2] Sears Holdings Corp., 2010-2017 Forms 10-K.
[3] 2019 Project Transform Liquidity Analysis.

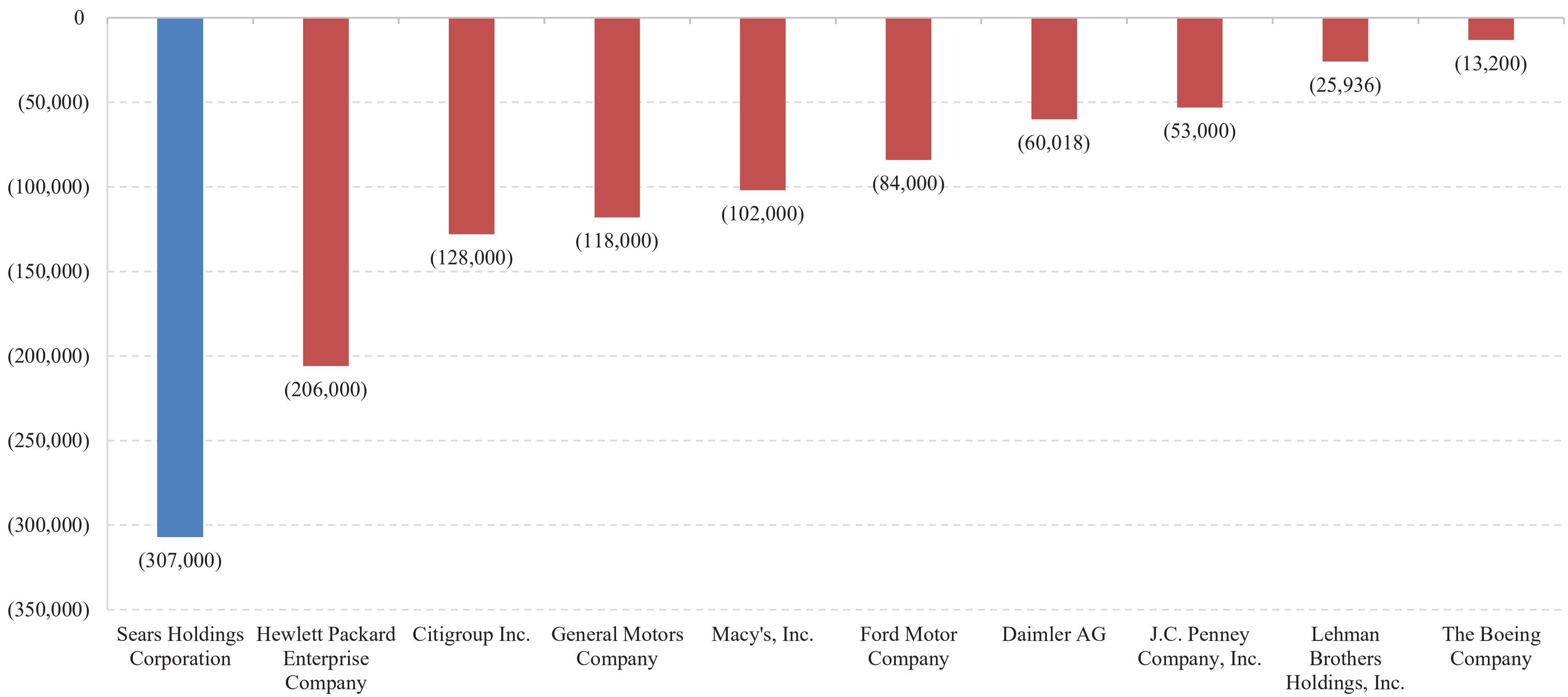
Exhibit 2
Sears Historical EBITDAP
2010 - 2018

[redacted]

Notes:
[1] EBITDAP excludes non-comp items and REIT/JV rent.
[2] Sears's fiscal year begins in February.

Source:
[1] Sears Holdings Corp., *VFS Act Vs Plan 2010-18.xlsx*.

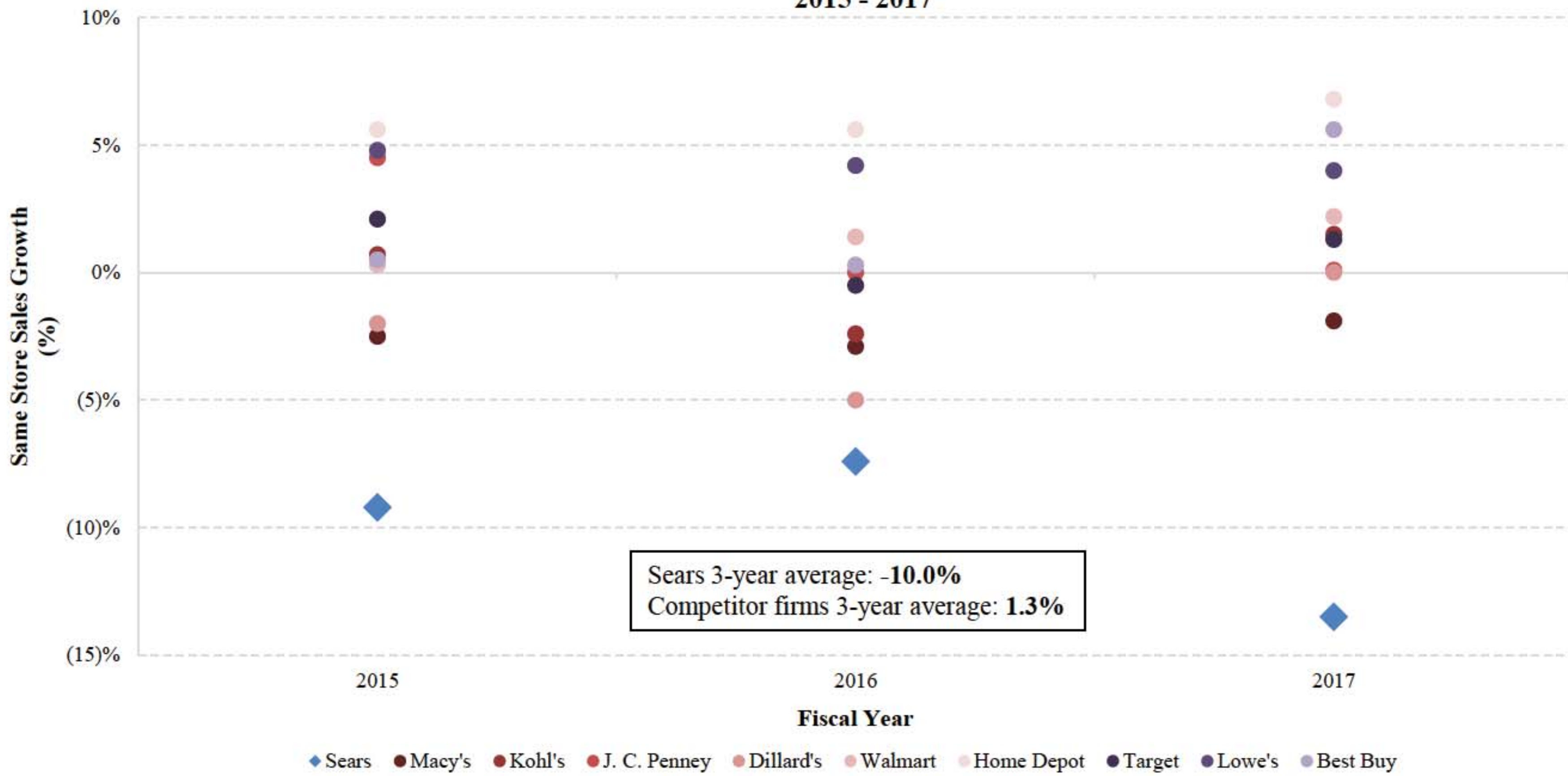
Exhibit 3
Total Job Cuts
2007 - 2018



Notes:
[1] Total job cuts for each company are calculated as the sum of the year-over-year change in number of global employees.
[2] The total number of Sears job cuts includes [redacted]
[3] The Hewlett Packard Enterprise year-over-year change includes the job cuts for HP Inc. ("HPQ").
[4] The GM year-over-year change for 2018 is sourced from the Q3 2018 10-Q assuming full utilization of voluntary severance program.
[5] Ford Motor Company reported its total number of employees for Fiscal Year 2018 in a January 2019 8-K.
[6] The total number of Daimler employees in 2018 is as of Q3 2018.
[7] The latest total number of Boeing employees is as of Fiscal Year 2017.

Sources:
[1] S&P Capital IQ, https://www.capitaliq.com/ (last visited Jan. 25, 2019).
[2] Daimler AG, Interim Report Q3 2018, Oct. 25, 2018.
[3] Ford Motor Co., Form 8-K, filed Jan. 23, 2019, Exhibit 99.2.

Exhibit 4
Comparison of Sears and Select Competitors
Same Store Sales Growth
2015 - 2017



Notes:
[1] Select competitors were chosen based on companies that are listed as comparable companies in the combination of analyst reports, Thomson, and Capital IQ.
[2] Macy's, Kohl's, J.C. Penney, Dillard's, Walmart, Home Depot, Target, Lowe's, and Best Buy had 3-year averages of -2.4%, -0.1%, 1.5%, -2.3%, 1.3%, 6.0%, 1.0%, 4.3%, and 2.1%, respectively.

Sources:
[1] S&P Capital IQ, https://www.capitaliq.com/ (last visited Jan. 25, 2019).
[2] Lowe's Co., Inc., 2017 Form 10-K, filed Apr. 2, 2018.
[3] Target Corp., 2017 Form 10-K, filed Mar. 14, 2018.
[4] The Home Depot, Inc., 2017 Form 10-K, filed Mar. 21, 2018.
[5] Walmart Inc., 2017 Form 10-K, filed Mar. 30, 2018.

Exhibit 5
U.S. Department Store Sales Growth
2002 - 2018

Note:
[1] November and December 2018 data is not available. Therefore, 2018 sales growth is calculated by comparing to the same period in 2017 (January - October 2017).

Source:
[1] United States Census Bureau, "Time Series / Trend Charts," https://www.census.gov/econ/currentdata/ (last visited Jan. 18, 2019).

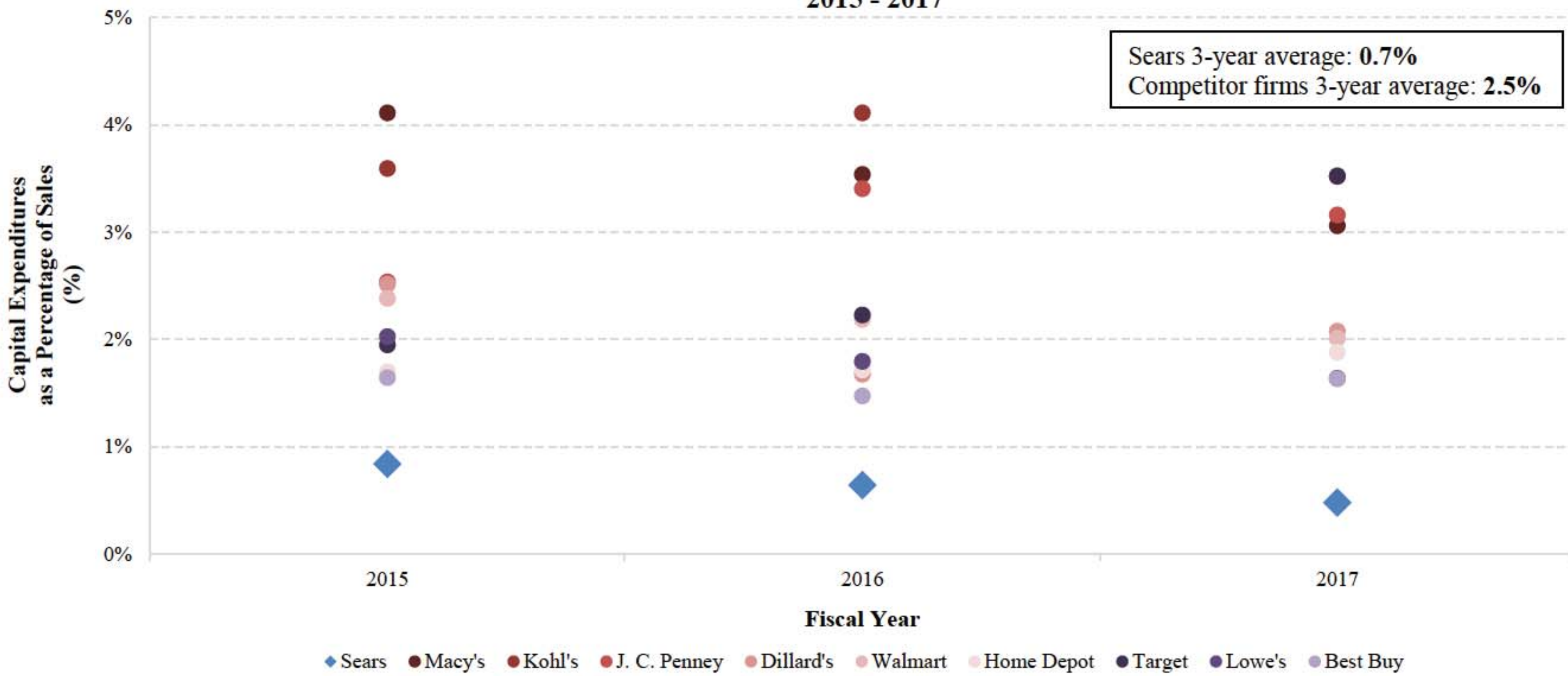
Exhibit 6
Historical Sears Online EBITDAP Margin
2010 - 2017

[redacted]

Notes:
[1] Historical Sears online EBITDAP margins are calculated by dividing the total business profits by total revenues for the "Online w/ Memo" category.
[2] Sears's fiscal year begins in February.

Source:
[1] Sears Holdings Corp., *FY 2010-2018 BU Recaps.xlsx*.

Exhibit 7
Comparison of Sears and Select Competitors
Capital Expenditures as a Percentage of Sales
2015 - 2017



Notes:
[1] Select competitors were chosen based on companies that are listed as comparable companies in the combination of analyst reports, Thomson, and Capital IQ.
[2] Macy's, Kohl's, J.C. Penney, Dillard's, Walmart, Home Depot, Target, Lowe's, and Best Buy had 3-year averages of 3.6%, 3.7%, 3.0%, 2.1%, 2.2%, 1.8%, 2.6%, 1.8%, and 1.6%, respectively.

Sources:
[1] Dillard's, Inc., 2015-2017 Forms 10-K.
[2] J. C. Penney Co., Inc., 2017 Form 10-KA, Amendment No. 1 to Annual Report, filed May 30, 2018.
[3] Kohl's Corp., 2017 Form 10-K, filed Mar. 23, 2018.
[4] Lowe's Co., Inc., 2017 Form 10-K, filed Apr. 2, 2018.
[5] Macy's Inc., 2017 Form 10-K, filed Apr. 4, 2018.
[6] Sears Holdings Corp., 2017 Form 10-K, filed Mar. 23, 2018.
[7] Target Corp., 2017 Form 10-K, filed Mar. 14, 2018.
[8] The Home Depot, Inc., 2017 Form 10-K, filed Mar. 21, 2018.
[9] Walmart Inc., 2017 Form 10-K, filed Mar. 30, 2018.

Exhibit 8
Total Marketing Expense per Store
2010 - 2017

[redacted]

Notes:
[1] Marketing expenses are limited to store and online marketing expenses charged to Sears and Kmart full-line stores.
[2] The total marketing expense per store is calculated based on the number of U.S. full-line stores.
[3] Sears's fiscal year begins in February.

Sources:
[1] Sears Holdings Corp., *FY 2010-2018 BU Recaps.xlsx*.
[2] Sears Holdings Corp., 2010-2017 Forms 10-K.

Exhibit 9
Overview of Sears Initiatives Outlined in Management Plans and 2019 ESL Business Plan
2013 - 2019

	Management Plans						
Initiatives	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019 ESL Business Plan**
[redacted]							

[1] The above list includes selected initiatives from the Management Plans, 2019 ELS Business Plan, and interview transcripts.
[2] [redacted]

Sources:

[1] Sears Holdings Corp., *2013 Plan Update* , Jan. 23, 2013, pp. 6-7, 10, 12, 20-23, 46, and 52-75.

[2] Sears Holdings Corp., *2014 Plan Review* , Jan. 22, 2014, pp. 21-129.

[3] Sears Holdings Corp., *2015 Plan Review* , Jan. 21, 2015, pp. 37-53.

[4] Sears Holdings Corp., *2016 Plan Update* , Jan. 28, 2016, pp. 8, 11, 13, and 18.

[5] Sears Holdings Corp., *2017 Plan Update* , Feb. 8, 2017, pp. 4 and 19-21.

[6] Sears Holdings Corp., *2018 Plan Review* , Jan. 30, 2018, pp. 10-11 and 13-14.

[7] Sears Holdings Corp., *Preliminary Business Plan* , Dec. 2018, p. 18.

[8] 2019 Project Transform Liquidity Analysis, pp. 2 and 4.

[9] 2019 Project Transform Business Plan, pp. 4, 6, 46, 51, 52, and 53.

[10] Riecker Interview Transcript.

[11] Lampert Interview Transcript.

[12] Sinha Interview Transcript.

[13] Kamlani Interview Transcript.

Exhibit 10
Comparison of Sears Actual and Planned Total Revenue
2010 - 2017

[redacted]

Note:
[1] Sears's fiscal year begins in February.

Source:
[1] Sears Holdings Corp., *VFS Act Vs Plan 2010-18.xlsx*.

Exhibit 11
Comparison of Sears Actual and Planned Gross Margin
2010 - 2017

[redacted]

Note:
[1] Sears's fiscal year begins in February.

Source:
[1] Sears Holdings Corp., *VFS Act Vs Plan 2010-18.xlsx*.

Exhibit 12
Comparison of Sears Actual and Planned EBITDAP
2010 - 2017

[redacted]

Notes:
[1] EBITDAP excludes non-comp items and REIT/JV rent.
[2] Sears's fiscal year begins in February.

Source:
[1] Sears Holdings Corp., *VFS Act Vs Plan 2010-18.xlsx*.

Exhibit 13

Historical EBITDAP Margins for 425 Go-Forward Sears Stores in 2019 ESL Business Plan

2010 - 2018

[redacted]

Notes:

[1] Top 70 stores are selected from the 425 ongoing stores based on 2017 EBITDAP margin, *i.e.*, all 425 Go-Forward Stores includes the Top 70 Go-Foward Stores.

[2] Sears's fiscal year begins in February.

Sources:

[1] Sears Holdings Corp., *505 + SAC 24 Trailing Months (2).xlsx.*

[2] Sears Holdings Corp., *2010-17 Store Data by Year.xlsx.*

Exhibit 14
Comparison of Sears Prior EBITDAP to Forecasted EBITDAP in the 2019 ESL Business Plan
2015 - 2021

[redacted]

Note:
[1] Sears's fiscal year begins in February.

Source:
[1] 2019 Project Transform Liquidity Analysis.

Exhibit 15
Sears Business Unit EBITDAP Margin before Deducting Corporate SG&A and Other Adjustments
2015 - 2021

[redacted]

Notes:
[1] Business Unit EBITDAP Margin before deducting Corporate SG&A and Other Adjustments denotes operating margins before Home Office / Corporate SG&A and Supply Chain and Innovel.
[2] The reported operating margins come from the 2019 Liquidity Analysis prepared by ESL.
[3] Sears's fiscal year begins in February.

Source:
[1] 2019 Project Transform Liquidity Analysis.

Exhibit 16
Sears Actual and Planned Revenues by Business Units
2015 - 2021

[redacted]

Notes:
[1] Percentages denote retail revenue as a percent of total revenue.
[2] Sears's fiscal year begins in February.

Source:
[1] 2019 Project Transform Liquidity Analysis.

Exhibit 17
Historical Average Sales per Store for 425 Go-Forward Sears Stores in 2019 ESL Business Plan
2010 - 2018

[redacted]

Note:
[1] Sears's fiscal year begins in February.

Sources:
[1] Sears Holdings Corp., *505 + SAC 24 Trailing Months (2).xlsx.*
[2] Sears Holdings Corp., *2010-17 Store Data by Year.xlsx.*

Exhibit 18
Same Store Sales Growth for 425 Go-Forward Sears Stores in 2019 ESL Business Plan
2011 - 2018

[redacted]

Note:
[1] Sears's fiscal year begins in February.

Sources:
[1] Sears Holdings Corp., *505 + SAC 24 Trailing Months (2).xlsx.*
[2] Sears Holdings Corp., *2010-17 Store Data by Year.xlsx.*

Exhibit 19
Year-over-Year Change in Same Store Monthly Sales for 425 Go-Forward Sears Stores in 2019 ESL Business Plan
February 2018 - December 2019

[redacted]

Note:
[1] Year over year change in same store monthly sales for November 2018 - January 2019 are for 545 stores as of January 2019. This includes 40 Going Out of Business (“GOB”) stores, until those stores are closed.

Source:
[1] Sears Holdings Corp., *505 + SAC 24 Trailing Months (2).xlsx.*
[2] Sears Holdings Corp., *SSS Weekly Sales Reports*.

Exhibit 20
Performance by Business Unit
2015 - 2021

[redacted]

Note:
[1]

Source:
[1] 2019 Project Transform Liquidity Analysis.

Exhibit 21
Shop Your Way Active Membership
2012 - 2017

[redacted]

Note:
[1] Sears's fiscal year begins in February.

Source:
[1] ESL Investments, *Shop Your Way Data Request* (RS_SHC_00324749).

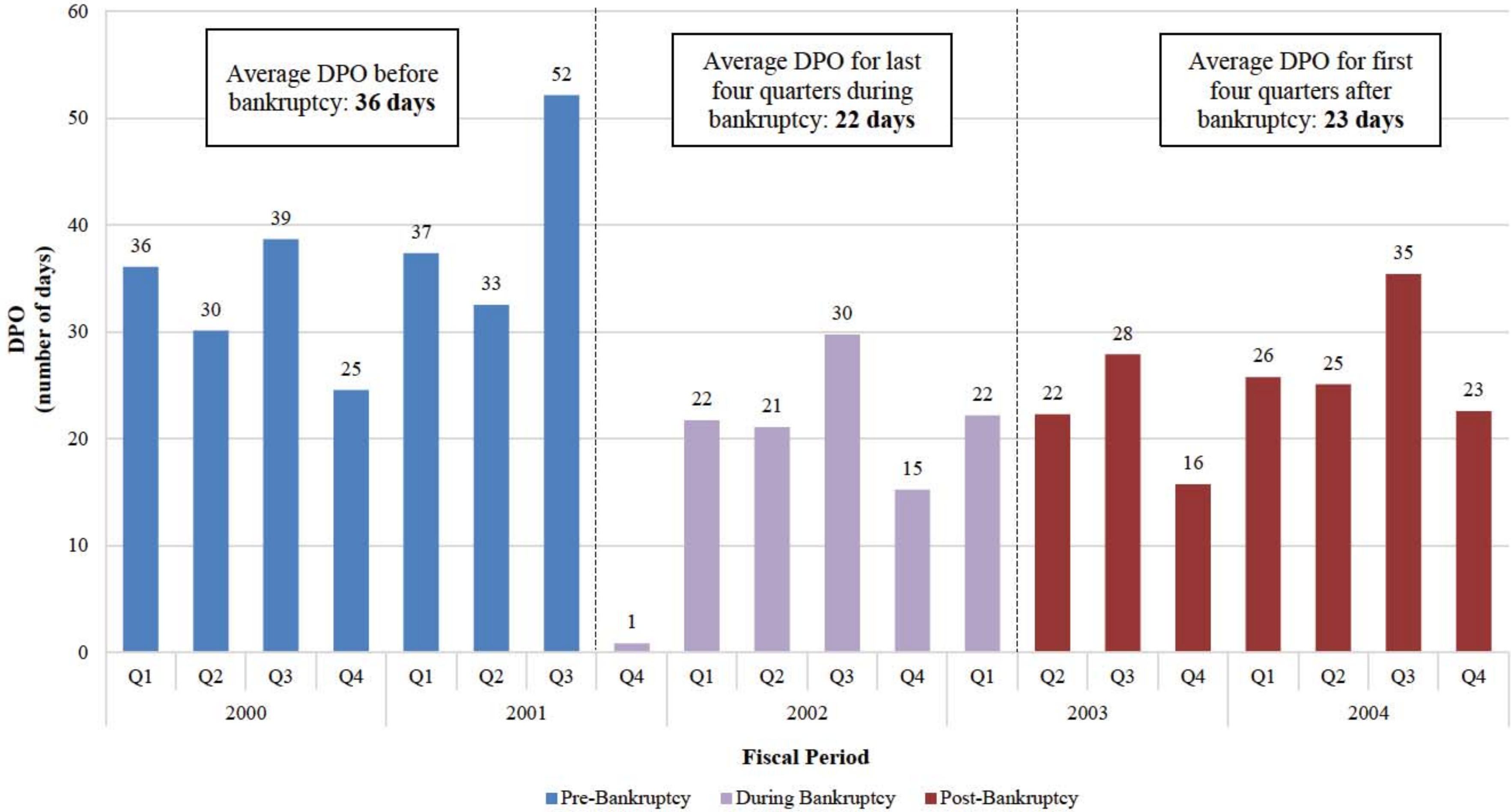
Exhibit 22
Comparison of Actual and Planned Sears Days Payable Outstanding ("DPO")

[redacted]

Notes:
[1] DPO is calculated as Merchandise Payable / Cost of Sales, Buying, and Occupancy * Days in Fiscal Period. Cost of Sales, Buying, and Occupancy includes merchandise sales to Sears Hometown and Outlet Stores starting in 2012 and rent expenses to Seritage starting in 2015.
[2] DPO for 2018 Q3 is affected by the stay imposed under bankruptcy law to accounts payable prior to October 15, 2018. See Sears 2018 10-Q Q3, p. 19.
[3] As of the time of this report, Sears has not released financials for 2018 Q4.
[4] [redacted]

Sources:
[1] Sears Holdings Corp., 2011-2017 Forms 10-K.
[2] Sears Holdings Corp., 2018 Forms 10-Q.
[3] 2019 Project Transform Liquidity Analysis.

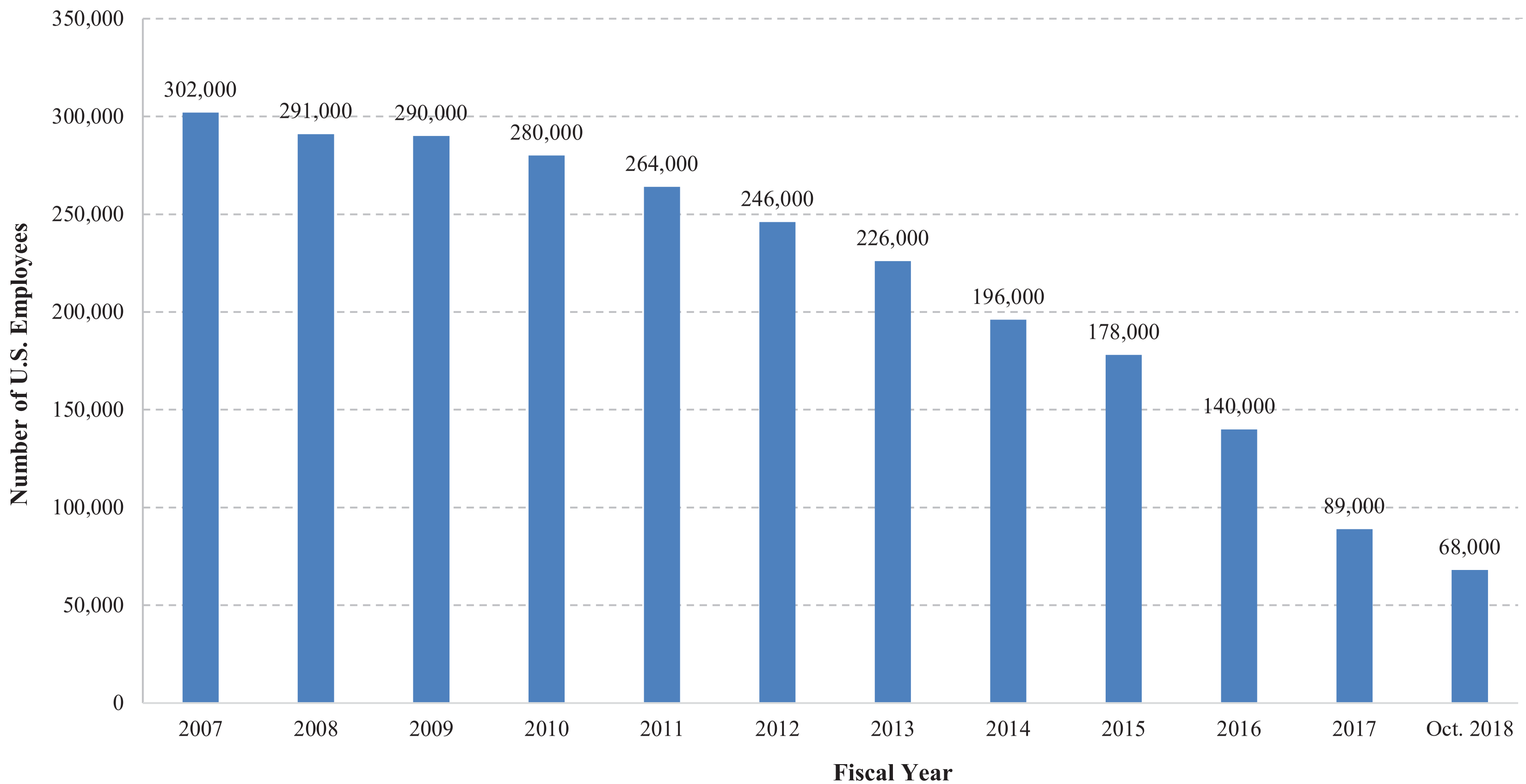
Exhibit 23
Comparison of Kmart DPO Before and After Bankruptcy



Note:
[1] Kmart filed for bankruptcy on January 22, 2002, shortly before the end of 2001 Q4. It emerged from bankruptcy on May 6, 2003, shortly after the beginning of 2003 Q2.
[2] DPO for 2001 Q4 is affected by the stay imposed under bankruptcy law to accounts payable prior to January 22, 2002. See Kmart 2001 10-K, p. 48.

Sources:
[1] Kmart Corp. and Kmart Holding Corp., 2000-2004 Forms 10-Q and 10-QA.
[2] Kmart Corp. and Kmart Holding Corp., 2000-2004 Forms 10-K and 10-KA.

Exhibit 24
Total Number of U.S. Sears Employees
2007 - 2019



Notes:
[1] The number of U.S. Sears employees includes all full-time and part-time employees in the United States and U.S. territories for subsidiaries of Sears Holdings Corporation.
[2] Sears's fiscal year begins in February.

Sources:
[1] Sears Holdings Corp., 2007-2017 Forms 10-K.
[2] Alistair Gray, "Sears Races to Avoid Outright Liquidation after Bankruptcy Filing," *Fin. Times* (Oct. 15, 2018), https://www.ft.com/content/57cd862a-d038-11e8-a9f2-7574db66bcd5.
[3] Kamlani Dep., p. 153.

APPENDIX A

Jan Rogers Kniffen
Curriculum Vitae

EXPERIENCE

J. ROGERS KNIFFEN WORLDWIDE ENTERPRISES, LLC **2005 – Present**
CEO, Retail Consulting

- J. Rogers Kniffen Worldwide Enterprises LLC (JRKWWE) provides equity research and financial and management consulting services relating to companies in the retail sector.
- JRKWWE covers U.S.-based and international retailers, including department stores, teen and missy specialty retailers, fashion forward specialty retailers, broad appeal specialty stores, discounters, off-price retailers, and suppliers. The consulting services include acquisition due diligence, benchmarking, competitive analyses, financial analysis, investor relations advisement, and market assessments.
- JRKWWE has provided due diligence to private equity firms on retail investment decisions.
- JRKWWE is retained by institutional investors for consulting services on investments in retailers, having retainer agreements with institutional investors across the globe.

THE MAY DEPARTMENT STORES COMPANY **1985 – 2005**
Senior Vice President & Treasurer (1991 – 2005)

- Responsible for long range financial planning, acquisition analysis, investor relations, treasury operations, risk management, safety, pension, profit sharing, foundation asset management, and communications.
- Valued and funded the acquisition of Marshall Field's, and valued and executed the spin-off of Payless ShoeSource.
- Served on the financial disclosure committee, and served as liaison to the Finance Committee of the Board of Directors.
- Chartered and was President of May National Bank of Ohio, May National Bank of Maryland, and May National Bank of Arizona, and was president of the Vermont domiciled Leadville and Snowdin captive insurance subsidiaries.
- Responsible for Federal, State, and local tax
- Responsible for interaction and audits with the OCC and Commissioner of Insurance Regulation.

Vice President and Treasurer (1986 – 1991)

- Led and funded the spin-off of Venture Stores through real estate and inventory financing, the sale of Caldor, the purchase of Foley's and Filene's, and Strawbridge's, and accomplished the pooling-of-interest merger with Associated Dry Goods, at the time the largest acquisition in retailing.
- Led the sale and leaseback of 100 department stores, and formed real estate and shopping center partnership to divest 26 shopping centers in a tax efficient transaction.

Director of Corporate Finance and Assistant Treasurer (1985 – 1986)

LINDENWOOD UNIVERSITY **1978 – 2005**
Adjunct Professor of Business Administration, Finance

ACF INDUSTRIES, INC / ICAHN AND CO. **1972 – 1985**
Director of Corporate Finance /Assistant Treasurer (1984 – 1985)

- Reported directly to the treasurer of Icahn and Co., handled the divestiture of three operating companies, and issued the largest junk bond offering in history to that point.

Director of Business Planning, Estimates and Scheduling (1982 – 1984)
Director of Estimates and Proposals (1980 – 1982)
Manager of Sales and Lease Administration (1979 – 1980)
Senior Planner for Strategic Planning, Senior Market Analyst, Market Analyst, Sales Representative (1972 – 1979)

MILITARY SERVICE

U.S. Air Force - served to Captain, 1970 – 1977

EDUCATION

St. Louis University - doctoral program in Finance, 1985 – 1986
M.B.A., Lindenwood University, Finance and M.I.S., 1978
B.S., Southern Illinois University, Journalism, 1971
University of Illinois, English major, 1966 – 1968

MEDIA

Regularly appear as a contributor for retail news on CNBC.
Regularly appeared as a retail expert on BNN, FBN and CBC prior to signing with CNBC.
Frequently quoted in print regarding retail.

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APPENDIX C

Restructuring Examples

1. In this Appendix I discuss restructuring examples undertaken by other retailers. Numerous retailers who faced similar challenges to those of Sears implemented restructuring plans and experienced a subsequent decline in their revenue.

2. In the early 2000s, Tommy Hilfiger was struggling with falling revenue and a diluted brand because of too much product discounting.[1] After a leveraged buyout, the company implemented a restructuring plan that cut 40 percent of U.S. headcount and invested in new retail locations.[2] Based on their stated strategy, I would have expected revenue to decline, and in fact Tommy Hilfiger's CEO at the time did too, stating, "[y]ou couldn't do this kind of turnaround at a publicly traded company. It would be too extreme, and you'd shrink the top line too dramatically."[3] I recall that Hilfiger's North American revenues declined a further 20 percent through the restructuring, returning to growth in 2009.

3. J.C. Penney is another retailer that experienced a similar fate during its restructuring attempt in 2012. The company announced a plan to cut $900 million in SG&A over two years through layoffs and by reducing the number of promotions run.[4] I attended the meeting when Ron Johnson, then the CEO of J.C. Penney, announced the restructuring. While this was an amazing restructuring of an old line retail company that clearly needed to be restructured, at the time, I expected that J.C. Penney's revenue would drop 20 percent during the first quarter after restructuring and continue to drop in the following

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quarter. I expected such a large drop because we (May) had tested, on a much smaller scale, some version of almost every change that was being implemented at J.C. Penney. In my experience, no retailer had ever undertaken so many changes affecting so many stores in such a short time period. While reorganizations usually cause revenue drops in the 4 percent to 8 percent range, I was convinced that J.C. Penney's substantial reorganization coupled with a complete change in pricing policy, vendor structure, and store layout would cause a drop in revenue of about three times the normal magnitude. In fact, same store revenue dropped 19 percent that first quarter with total net revenue falling approximately 25 percent in 2012 (the first year of the restructuring), and then another 9 percent in 2013 before stabilizing.[5] Meanwhile, gross margin dropped from 36 percent in 2011 to 31 percent in 2012 and 29 percent in 2013. By 2015, $1.33B in SG&A had been cut, revenues were stable, gross margins had returned to pre-restructuring levels, and many believed that J.C. Penney, while not exactly healthy, had been saved from certain disaster.[6]

4. There are also examples of firms that closed retail locations and experienced a similar decline in revenues. For example, in June 2014, Coach announced it would close 20 percent of its stores in North America.[7] The firm's guidance for 2015 called for a "low double-digit" decline in revenue, "primarily due to store closures," and the CEO told investors "to expect about eight quarters…before North American revenue would turn around."[8] The actual results were right in line with Coach's expectations: revenue

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5 Maureen Farrell, "J.C. Penney Stock Sinks on Falling Sales" (May 16, 2012), https://money.cnn.com/2012/05/15/markets/jc-penney-stock/index.htm; J.C. Penney Company, Inc. Form 10-K for the fiscal year ended February 1, 2014 (p. 58).

6 J.C. Penney Company, Inc. Form 10-K for the fiscal year ended February 1, 2014 (p. 58); J.C. Penney Company, Inc. Form 10-K for the fiscal year ended January 31, 2015 (p. 61); J.C. Penney Company, Inc. Form 10-K for the fiscal year ended February 3, 2018 (p. 62); Adam Levine-Weinberg, "Cost-Cutting Is the Key to J.C. Penney's Turnaround," *The Motley Fool* (Aug 20, 2015), https://www.fool.com/investing/general/2015/08/20/cost-cutting-is-the-key-to-jc-penneys-turnaround.aspx.

7 Phil Wahba, "Coach Thinks Outside the Bag," *Fortune* (May 24, 2017), http://fortune.com/2017/05/24/coach-victor-luis-stuart-vevers/.

8 Phalguni Soni, "Coach's 3Q15 Earnings Beat Estimates, but Stock Plunges Anyway," *Market Realist* (April 30, 2015), https://marketrealist.com/2015/04/future-opportunities-challenges-coach; Phil Wahba, "Coach Thinks Outside the Bag," *Fortune* (May 24, 2017), http://fortune.com/2017/05/24/coach-victor-luis-stuart-vevers/.

dropped 12.7 percent in the first year after stores were closed before stabilizing two years later.[9]

5. Ralph Lauren also announced a new long-term strategy in 2016 that centered on shrinking and refocusing the firm. This plan included both cutting headcount by 8 percent and closing around 50 stores.[10] The firm's guidance called for double-digit declines in revenue during the first year of restructuring with expectations that performance would stabilize in fiscal 2018.[11] Actual revenues eventually declined over 15 percent in North America and 10 percent overall during fiscal 2017.[12] Revenue took longer than expected to turn around with further declines in 2018, demonstrating the challenges associated with such a significant restructuring plan.[13]

6. Even well-performing retailers experience declines in their revenues when undertaking a restructuring. The May Department Store Company executed numerous acquisitions and mergers in which stores were closed, staff were laid off, and overhead expenses were cut. Examples include Thalhimer's merger with Hecht's, Strawbridge's merger with Hecht's, L.S. Ayres' merger with Famous-Barr, The Jones Store's merger with Famous-Barr, Kaufmann's merger with Filene's, May Company California's merger with J.W. Robinson's, May D&F's merger with Denver Dry Goods Company, May D&F's merger with Foley's, and Meier & Frank's merger with Robinsons-May. In the 2002 merger of Kaufmann's with Filene's, May closed Kaufmann's headquarters and combined the back-office operations of the two business divisions. After the consolidation, revenue for the combined division fell more than for May as a whole.[14] The May Department Store Company had years of experience merging operations, cutting costs, and streamlining its

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9 Phil Wahba, "Coach Thinks Outside the Bag," *Fortune* (May 24, 2017), http://fortune.com/2017/05/24/coach-victor-luis-stuart-vevers/; Coach, Inc. Form 10-K for the fiscal year ended July 2, 2016 (p. 26).

10 Trefis Team, "The Main Facets of Ralph Lauren's Turnaround Plan," *Forbes* (August 1, 2016), https://www forbes.com/sites/greatspeculations/2016/08/01/the-main-facets-of-ralph-laurens-turnaround-plan/#11247c90507b.

11 Ralph Lauren Corporation. "Ralph Lauren Corporation Presents "Way Forward" Plan and Financial Outlook" (June 7, 2016), http://investor.ralphlauren.com/phoenix.zhtml?c=65933&p=irol-newsArticle&ID=2175676.

12 Ralph Lauren Corporation Form 10-K for the fiscal year ended March 31, 2018 (pp. 50-51).

13 Ralph Lauren Corporation Form 10-K for the fiscal year ended March 31, 2018 (pp. 44-45).

14 The May Department Stores Company Form 10-K for the fiscal year ended February 1, 2003 (p. 9); The May Department Stores Company Form 10-K for the fiscal year ended January 29, 2005 (p. 16).

business and yet it still faced the same expected decline in near-term revenues when implementing restructuring plans.

Exhibit D

Greenspan Report

***In re Sears Holdings Corporation, et al.*, Debtors**

Case No. 18 23538 (RDD)
United States Bankruptcy Court
Southern District of New York

Expert Report
of
Ronald F. Greenspan
Senior Managing Director, FTI Consulting, Inc.
January 26, 2019

Table of Contents

A. Scope of Retention and Compensation

I have prepared this report ("Report") at the request of Akin Gump Strauss Hauer & Feld LLP ("Akin" or "Committee Counsel"), counsel to the Official Committee of Unsecured Creditors (the "Creditors' Committee") of Sears Holdings Corporation ("SHC") and its affiliated debtors and debtors in possession (collectively, the "Debtors" and, together with their non-Debtor affiliates, "Sears"), whose chapter 11 cases (the "Chapter 11 Cases") are pending before the United States Bankruptcy Court for the Southern District of New York (the "Court").

My analyses and opinions below address (i) the process undertaken by the Debtors to market certain of their real estate interests and their estimate of proceeds from such dispositions, and (ii) the fair market realizable value of the Debtors' real estate interests in an orderly wind-down process.

The opinions and conclusions expressed in this Report are based on my knowledge and experience in the real estate and restructuring industries, my review of the Debtors' valuation analyses and methodology used to support their wind-down analysis ("Debtors' Wind down Analysis"), review of documents provided by the Debtors, market research and the application of accepted valuation methodologies and analytical methods. Appendix C contains a list of the documents I considered in connection with my analysis. FTI Consulting is being compensated for my time based on an hourly billing rate of $1,195 and this compensation is not contingent upon my findings or the outcome of this proceeding.

I reserve the right to update and supplement this Report as additional materials and information are provided or otherwise made available to me.

B. Summary of Qualifications

I am a Senior Managing Director at FTI Consulting, Inc. ("FTI"). I lead FTI's Corporate Finance/Restructuring Practice in the Western United States and co lead FTI's Global Real Estate Solutions Practice, which we believe is the largest real estate consultancy outside of the Big 4 accounting firms. I have held this position at FTI (and its predecessor, PricewaterhouseCoopers Real Estate Restructuring Practice) since 1991.

I have over thirty five years of experience across all aspects of the real estate industry, including the development, sale, financing, operation of and investment in real property including retail, residential, mixed-use, office, industrial, hospitality and other types of real property. I hold a Certificate in Distressed Business Valuation ("CDBV") from the Association of Insolvency and Restructuring Advisors, am a Fellow of the American College of Bankruptcy and hold both the Certified Insolvency and Restructuring Advisor and Certified Turnaround Professional designations. I have conducted many valuation analyses of real property interests, businesses and securities in distressed and non distressed circumstances. I have lectured widely and have contributed articles to the American Bankruptcy Institute (ABI) Journal, American Banker and the Journal of the Urban Land Institute. I hold a J.D. from Harvard Law School and a B.A. in Economics from the University of California, Los Angeles.

I have been qualified as an expert and have presented testimony in state and federal courts throughout the United States, often involving issues associated with real property interests and the value thereof. My curriculum vitae and list of publications and prior testimony are attached as Appendix A of this Report.

C. Summary of Opinions

After reviewing the Debtors' estimated proceeds of its real estate through a wind down, its support therefor and empirical data for the relevant markets, I have formed the following opinions:

Opinion 1 – [redacted]

Opinion 2 [redacted]

***D.* Debtors' Real Estate Portfolio**

The Debtors' real estate portfolio is comprised of [redacted]

1 [redacted]

Exhibit 1
Debtors' Properties by Asset Type

[redacted]

The forms of ownership of the above-referenced properties are summarized in Exhibit 2. Of the [redacted]

Exhibit 2
Debtors' Properties by Ownership Type

[redacted]

Exhibit 3 shows the number of Debtors' properties that are [redacted]

Exhibit 3
Debtors' Properties by Encumbrance

[redacted]

E. Debtors' Wind-Down Analysis

[redacted]

[redacted]

[redacted]

2 [redacted] - [redacted]

3 [redacted]

4 [redacted]

5) [redacted]

Exhibit 4 summarizes what I understand to be the Debtors' most recent [redacted]

Exhibit 4
Debtors' Estimated Wind-Down Proceeds
By Debtor Categorization, Included and Excluded
($ in millions)

[redacted]

F. Bases for Opinions

Opinion 1 [redacted]

[redacted]

[redacted]

Flaw 1 – [redacted]

[redacted]

[redacted]

Exhibit 5

[redacted]

[redacted]

Flaw 2 – [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Exhibit 6

Illustration of Debtors' [redacted]

[redacted]

[redacted]

1) The Debtors did not run a robust real estate marketing sales process and, therefore, non-binding IOIs submitted as part of that process are simply not a reliable indicator of the market value of any properties. As described in the Declaration of Saul Burian, the Debtors' process was haphazard, rushed, and not well planned. A commercially reasonable disposition process would involve a proactive marketing effort with broad outreach to potential buyers, with sufficient information and time provided for buyer diligence to take place, the time for which would necessarily vary based on the complexity of the asset and its highest and best use. [redacted]

2) The non-binding, haphazard, and convoluted sale process fostered participation by opportunistic players who could submit lowball offers with no cost or penalty. Further, the Debtors' process incentivized stakeholders, particularly landlords, to submit what can best be described as placeholder bids as a means of expressing interest and opening a channel for negotiations (which if pursued by the Debtors could only result in higher not lower proceeds than the opening offer by the landlord). [redacted]

[redacted]

[redacted]

6 [redacted]

Exhibit 7
Effect of Debtors' [redacted]

[redacted]

Opinion 2 A commercially reasonable disposition strategy for the Debtors' real estate assets would result in proceeds ranging from [redacted]

Exhibit 8
Estimated Values and Range of Estimated Sales Proceeds
By Valuation Source
($ in millions)

[redacted]

My methodology for estimating recovery proceeds incorporates (and discounts) the Debtors' own appraisals[7] and broker opinions of value ("BOV"), when available. If the asset did not have a JLL Appraisal or A&G 2018 Value or BOV, but had a Cushman & Wakefield Appraisal, then I incorporated (and discounted) the Cushman & Wakefield "As If Dark" market value estimate (which accounts for Debtors vacating the premises).[8]

For the remaining assets – those for which the Debtors did not procure third-party appraisals or BOVs – I applied generally-accepted real estate valuation methodologies to estimate a value for these assets using Discounted Cash Flow, Direct Capitalization, and/or Sales Comparison techniques. I valued these properties by applying market assumptions predicated on property-specific. The assumptions (and hence values) were informed by data from actual Sears/Kmart transactions (of which there have been hundreds), market data extracted from relevant appraisals, other third-party sources, and CoStar data.[9] My independent valuations represent only [redacted] In other words, the Debtors' own professional valuations, as discounted, account for [redacted] of my valuation conclusions. A summary of the methodology I employed is included in Appendix B.

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7 [redacted]

8 The "As if Dark" appraisal assumes that Sears vacates and the vacant property is then sold.

9 [redacted]

After determining the market value of the properties (as dark), I then determined and applied an appropriate discount from market value to estimate expected proceeds in an orderly wind down process and also to account for an appropriate risk that the market value is overstated (which risk I believe to be relatively low given the valuation methodology employed). My assumption is that there will be adequate time for a marketing process to allow the properties to be sold at reasonable market value (as dark), rather than fire sale liquidation values. I then calculated carrying costs for the real estate during this marketing period. I believe that the assumption of an orderly monetization is appropriate and have calculated discount estimates accordingly.

My discount methodology is detailed in Exhibit 9. I estimated Low, Medium and High discounts based on ownership and property type. Property types that have the highest marketability in the current environment, such as distribution facilities, have the lowest discount percentage; property types that enjoy lower market interest currently, such as office (including the SHC Corporate Headquarters), have higher discounts. These discount ranges were developed based on our experience in orderly property monetizations as well as familiarity with the valuation methodologies applied.

Exhibit 9
FTI Range of Discounts
By Asset Type

FTI Discount		Leasehold			Owned	
Asset Format	**Low**	**Mid**	**High**	**Low**	**Mid**	**High**
Diehard Auto Center	40.0%	30.0%	20.0%	30.0%	20.0%	10.0%
Distribution Center	30.0%	20.0%	10.0%	20.0%	10.0%	0.0%
Home Services	30.0%	20.0%	10.0%	20.0%	10.0%	0.0%
Kmart	40.0%	30.0%	20.0%	30.0%	20.0%	10.0%
Logistics	30.0%	20.0%	10.0%	20.0%	10.0%	0.0%
Office	60.0%	50.0%	40.0%	50.0%	40.0%	30.0%
Sears Auto Center	40.0%	30.0%	20.0%	30.0%	20.0%	10.0%
Sears	40.0%	30.0%	20.0%	30.0%	20.0%	10.0%
Underutilized Property	40.0%	30.0%	20.0%	30.0%	20.0%	10.0%
Warehouse, Miscellaneous, or Other	30.0%	20.0%	10.0%	20.0%	10.0%	0.0%

Overall, the discount from Low to High ranges from 0% to 60%. The lowest range is a 0% to 20% discount for owned warehouse, distribution and logistics facilities. This is a property type which is currently experiencing high demand from buyers because of the growth of e-commerce and other factors. In fact, the national property data service CoStar reports that the large industrial market conditions have "never been stronger."[10] On the other hand, the highest discount range of 40% to 60% for leasehold office space reflects weaker market conditions for office product. The dollar-weighted average discount from market value to realizable value is 15% to 35% (before transaction and holding costs, which are excluded from the Debtors' estimated proceeds shown in this report). [redacted]

G. Conclusion

[redacted]

[10] Industrial Big Book, December 2018, published by CoStar, pg. 4

[redacted]

Where available, my analysis relies on Debtor-provided third-party appraisal and BOV information, which I then discount once to account for property type and risk. For those properties for which the Debtors have no appraisals or BOVs, my approach uses generally-accepted valuation methodologies. My methodologies include considering a wide-variety of real estate market data and multiple valuation approaches, including data from the Debtors' own substantial transactions. My analysis concludes that properties not valued by the Debtors are likely to generate [redacted] of proceeds (even after applying the wind-down discount) and reflects an appropriate level of conservatism to reflect market conditions in both its estimated market values and its discounts to estimate proceeds in an orderly monetization. With respect to the [redacted] the Debtors did value, I found that their flawed and highly unusual approach, which relied heavily on totally unreliable non-binding IOIs, undervalued the assets by [redacted]. I forecast a range of likely total real estate proceeds to be [redacted] (before transaction and holding costs).

Exhibit 10
Comparison of Debtor and FTI Estimated Proceeds
By Debtor Encumbrance, Included and Excluded
($ in millions)

[redacted]

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I reserve the right to update or modify this Report as additional information comes to my attention, including information that was unavailable as of the date of this Report.

Executed this 26th day of January 2019, at Los Angeles, California.

Ronald F. Greenspan

Appendix A – *Expert Qualifications*

Ronald F. Greenspan, CIRA, CTP, CDBV

Ronald Greenspan is a Senior Managing Director, co leader of the Real Estate Solutions group and leader of the FTI Corporate Finance West Region. Mr. Greenspan is an internationally respected finance and business reorganization professional with 39 years of diverse, hands-on experience. Mr. Greenspan applies his broad background to a wide variety of consulting, litigation and bankruptcy engagements, including corporate turnarounds, financial restructurings and bankruptcies. He is experienced in advising all stakeholders, including debtors, creditors and equity interests. His particular area of expertise include:

- Structuring and negotiating complex asset acquisitions, dispositions and financings.
- Analyzing, structuring and implementing loan modification and workout agreements.
- Preparing cash flow, disposition and valuation analyses.
- Bankruptcy consulting, including development and/or feasibility analyses of Plans of Reorganization on behalf of secured creditors, unsecured creditor committees, debtors and trustees.

Prior to joining FTI, Mr. Greenspan was a partner with PricewaterhouseCoopers and led its Global Real Estate Restructuring Group. Prior to that, he held senior management positions as the chief operating officer of Los Angeles Land Companies, as the executive vice president of Brookside Savings & Loan Association and as the executive vice president of Heritage Group, a vertically integrated, national real estate investment and management company.

Mr. Greenspan has advised on some of the largest and most complex real estate restructurings, including advising the Debtor that owned Rockefeller Center, the largest Creditor in the Olympia & York bankruptcy, advising numerous nationwide homebuilders, and resolving over $1,800,000,000 of disputed credits and troubled real estate assets as the financial consultant on the first RTC Settlement Workout Asset Team (SWAT).

Mr. Greenspan has extended his distressed loan and securitization expertise to the international arena, by establishing the PwC financial advisory services office in Tokyo, which office became a leading financial advisor in Asian distressed debt and nascent commercial and residential securitization markets.

Mr. Greenspan holds a Bachelors degree in economics, summa cum laude from U.C.L.A. and a J.D. from Harvard Law School, magna cum laude. He is also Member of the Urban Land Institute and a founding member of the Southern California Debt Enforcement and Restructuring Roundtable. He is a Fellow of the American College of Bankruptcy, a Certified Insolvency and Restructuring Advisor, a Certified Turnaround Professional, holds a Certification in Distressed Business Valuations, and is the past-President of the Los Angeles Bankruptcy Forum.

Mr. Greenspan is one of the most recognized and respected experts in the area of restructuring real estate and real estate-secured debt enterprises. He is sought as a speaker at prominent conferences such as the National Conference of Bankruptcy Judges, the Annual Meeting of the American Bankruptcy Institute, Annual Southeastern Regional Meeting, the Ninth Circuit Judicial Conference and the Chief Judges of the 9th Circuit. In addition, he is frequently quoted by the media including the Wall Street Journal, Financial Times, Bloomberg News, New York Times, Business Week and Forbes.

Mr. Greenspan has given numerous speeches and presentations at conferences, seminars and forums over the past 20 years. His topics have included "Subprime Mortgages: Wrecking the Housing Market and U.S. Economy One Loan at a Time", "Are We So Far Down That Everything is Up From Here?". "Surviving The Real Estate Correction and Capitalizing On Circumstances: What To Do With Extra Debt And Dirt", "Evolving Chapter 11 Practice from Case Filing to Plan Filing", "Introduction to Restructurings & Reorganizations for Asset Based Lenders," "Subprime and Warehouse Lending," and "Introduction to Bankruptcy." He also taught classes as a visiting instructor on financial, restructuring and real estate issues at the Northwest Center for Continuing Education, UCLA and UC Irvine Extension, and USC's Graduate School of Business.

Ronald F. Greenspan

Senior Managing Director — Corporate Finance/Restructuring

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Education
B.A. in Economics, summa cum laude, University of California, Los Angeles

J.D., magna cum laude, Harvard Law School

Certifications
Certification in Distressed Business Valuation

Certified Insolvency and Restructuring Advisor

Professional Affiliations
American Bankruptcy Institute

American College of Bankruptcy, Fellow

Association of Insolvency & Restructuring Advisors

California Bar Association (Inactive)

Los Angeles Bankruptcy Forum, Past President and Director

Urban Land Institute

Publications

- "Navigating the Structured Finance Waterfall: Smooth Sailing or a Barrel Ride Over the Falls?", CRE Finance World, October, 2012.
- "Money Changes Everything", *Daily Bankruptcy Review*, June 16, 2010.
- "2009 – It Was a Very _____ Year", *Daily Bankruptcy Review*, January 13, 2010.
- "Real Estate Workouts: Building a New Paradigm", *ABI Journal*, December, 2009.
- "Interview, Selection, Retention and Role of Financial Advisors", *Inside the Minds: The Role of Creditors' Committees in Chapter 11 Bankruptcies*, October, 2008.
- "Recovery in U.S. Homebuilding Sector is Likely to Take Several More Years", *Daily Bankruptcy Review*, April 16, 2008.
- "Predicting Corporate-Default Cycle Upended by History-Bucking Trends", *Daily Bankruptcy Review*, January 24, 2007.
- "Homebuilders: A Cycle Unlike Prior Cycles", *Daily Bankruptcy Review*, November 29, 2006.
- "KERPs Are Out, But Incentives Are In", *TMA Journal of Corporate Renewal*, 2006.
- "UnTill We Meet Again: Why Till Might Not Be the Last Word on Cram Down Interest Rates", *ABI Journal*, 2004.
- "The Un-real World of Troubled REITs", *ABI Journal*, 2001.

Expert Testimony and Depositions

	Deposition	Testimony
Fidelity Bond vs. Brand USBC - Eastern District of Pennsylvania	X	X
In re Pacific American Mortgage Company USBC - Central District of California		X
In re Maxicare, Inc. USBC - Central District of California	X	X
In re Aladdin Gaming LLC USBC – Nevada		X
In re Sandpiper-Golf Trust LLC v. Sandpiper at SBCR, LLC JAMS - Oxnard, California	X	X
In re Sutter's Place, Inc., dba Bay 101, Petitioner in the City of San Jose, State of California, Gaming Control Administration	X	X
In re Sierra Hospitality US District Court - Northern District of California	X	X
In re New Hotels, Inc. Central District of California	X	
In re Peregrine Systems, Inc. USBC - District of Delaware	X	X
In re Ardent Communications, Inc. USBC - District of Columbia	X	
LaSalle Bank National Association v. Lehman Brothers Holdings, Inc. US District Court - Maryland	X	X
In re Maple Leaf Farms, Inc. v. American Appraisal Associates, Inc., et al US District Court - Central District of California	X	
California Hotel Acquisition Company, LLC v. The Community Redevelopment Agency of the City of Los Angeles, California Los Angeles Superior Court	X	
American West Homes, Incorporated v. SoCal Housing Partners, L.L.C. US District Court - Central District of California	X	X
In re Heilig-Meyers Company USBC – Eastern District of Virginia	X	X
United States of America v. State Street Bank & Trust Company USBC Case No. A-01-4605-KJC Delaware District of Delaware	X	X

In re Commercial Money Center, Inc. USBC – Southern District of California	X	X

In re: Enron Corporation Securities Litigation MDL Docket No. 1446 US District Court - Southern District of Texas (Houston Division)	X	
In re Defendant and Plaintiff-in-Counterclaim in connection with Blue Hills Office Park LLC (Plaintiff, Defendant-in-Counterclaim) v. J.P. Morgan Chase Bank as Trustee for the Registered Holders of Credit Suisse First Boston Mortgage Securities Corp., Commercial Mortgage Pass-Through Certificates, Series 1999-C1 (the "Trust") and CSFB 1999-C1 Royall Street, LLC (Defendants, Plaintiffs-in-Counterclaim) v. William Langelier and Gerald Finberg (Defendants-in-Counterclaim). US District Court – District of Massachusetts	X	
In re Plaintiff in connection with LaSalle Bank National Association (f/k/a LaSalle National Bank), as Trustee for the Certificateholders of Asset Securitization Corporation Commercial Mortgage Pass-Through Certificates Series 1997-D5 (Plaintiff) v. Nomura Asset Capital Corporation and Asset Securitization Corporation (Defendants) US Supreme Court of the State of New York County of New York		X
In re Botanical Extracts, Inc., Hauser Technical Services, Inc., Zetapharm, Inc., d/b/a BI Nutriceuticals USBC – Central District of California		X
In re Wells Fargo Bank Minnesota N.A. et al v. UBS Warburg Real Estate Securities and UBS Paine Webber US District Court - Dallas County, Texas	X	X
In re LaSalle Bank National Association et al v. UBS Warburg Real Estate Securities and UBS Paine Webber US District Court - Dallas County, Texas		X
In re Wells Fargo Bank Minnesota N.A. et al v. Salomon Brothers Realty Corp., UBS Warburg Real Estate Securities, Inc., and Artesia Mortgage Capital Corporation US District Court - Dallas County, Texas		X
In re Wells Fargo Bank Minnesota N.A. et al v. Lehman Brothers Holdings, Inc. US District Court - Dallas County, Texas		X

In re Brobeck, Phleger & Harrison LLP USBC Case No. 03-32715-DM7 Northern District of California San Francisco Division		X
In re People's Choice Home Loan, Inc., et al., USBC Case No. SA-07-10765-RK Central District of California Santa Ana Division		X
In re South Coast Property Company 96-A, L.P. USBC – Central District of California	X	X
In re Yellowstone Mountain Club, LLC USBC Case No. 08-61570-RBK USBC – District of Montana	X	X
In re Teachers Insurance & Annuity Association of America, et al vs. Criimi Mae Services Limited Partnership, et al US District Court - Southern District of New York	X	
In re Westland Devco, LP US Bankruptcy Court – District of Delaware	X	X
In re Innkeepers USA Trust, et al. US Bankruptcy Court-Southern District of New York		X
In re GTS 900 F, LLC, a California limited liability company, aka Concerto US Bankruptcy Court – Central District of California Los Angeles Division		X
In re Orleans Homebuilders, Inc., et al. USBC Case No. 10-10684 (PJW) US Bankruptcy Court – District of Delaware		X
In re Wells Fargo Bank, National Association, a national banking association, as the B Note Holder and predecessor Administrative Agent and ATC Realty Sixteen, Inc., a California Corporation, as Administrative Agent in their claims against Aareal Capital Corporation, a Delaware corporation; MML RE Finance LLC, a Delaware LLC; Munchener Hypothekenbank EG, a German company; Deutsche Hypothekenbank AG, a German company, Defendants and Counter-Plaintiffs Case No. 8:10-cv-00714-DOC-RNB US District Court - Central District of California	X	
In re Philadelphia Rittenhouse Developer, L.P. Case No. 10-31201 US Bankruptcy Court–Eastern District of Pennsylvania	X	X

In re Walter E. Wolf, an individual, Plaintiff vs. Paul J. Borden, an individual, CDS DEVCO, INC., a California corporation; CDS HOLDING CORPORATION, a California corporation, SAN ELIJO RANCH, INC., a California corporation; HOMEFED CORPORATION, a Delaware corporation, and DOES 1 through 10, Defendants Case No. 37-2009-00093090-CU-BC-CTL Superior Court of the State of California for the County of San Diego	X	
In re Workflow Management, Inc., et al., Case No. 10-74617 (SCS) US Bankruptcy Court-Eastern District of Virginia Norfolk Division		X

In re ABN AMRO BANK N.V., et al vs. ERIC DINALLO, in his capacity as Superintendent of the New York State Insurance Department; the NEW YORK STATE INSURANCE DEPARTMENT; MBIA INC.; MBIA INSURANCE CORPORATION; and NATIONAL PUBLIC FINANCE GUARANTEE CORPORATION (f/k/a MBIA INSURANCE CORP. OF ILLINOIS),	X	
In re MSR Resort Golf Course LLC, et al., Case No. 11-10372 (SHL) Jointly Administered US Bankruptcy Court, Southern District of New York	X	X
In re R.E. LOANS, LLC, R.E. FUTURE, LLC and CAPITAL SALVAGE, a California corporation Case No. 11-35865-BJH Jointly Administered US Bankruptcy Court, Northern District Of Texas Dallas Division		X
In re Gateway Metro Center, LLC Case No. 2:11-bk-47919-BR US Bankruptcy Court, Central District of California	X	
In re Transwest Resort Properties, Inc. jointly administered Case No. 4:10-bk-37134-EWH US Bankruptcy Court, District of Arizona	X	
In re The Village at Lakeridge, LLC Case No. BK-N-11-51994-BTB US Bankruptcy Court, District of Nevada	X	
In re Residential Capital, LLC, et al., Case No. 12-12020 US Bankruptcy Court, Southern District of New York		X

In re 207 Redwood, LLC Case No. 10-27968-NVA For The District of Maryland	X	
In re Circus and Eldorado Joint Venture, et al., Case No. BK-12-51156 US Bankruptcy Court, District of Nevada	X	
In re Lanes End, LLC, Plaintiff vs. Baldwin, Alfred E., Baldwin & Sons, LLC Case No. 1240021217 Superior Court of the State of California County of San Diego – Central Division		X
U.S. Bank National Association, as Trustee for the Registered Holders of Wachovia Bank Commercial Mortgage Trust, Commercial Mortgage Pass-Through Certificates, Series 2006-C28, acting by and through its Special Servicer, CWCapital Asset Management LLC v. Dexia Real Estate Capital Markets Case No. 12-cv-09412-SAS US District Court for the Southern District of New York	X	
In re 431 W. Ponce de Leon, LLC, Cartel Properties Spalding Woods, LLC, 525 Moreland Avenue, LLC, Cartel Properties II, LLC, Rohrig Investments, LP, and Rohrig Pollack, LLC Residential Capital, LLC Case No. 13-53479-BEM Case No. 13-53480-BEM Case No. 13-53481-BEM Case No. 13-53482-BEM Case No. 13-53483-BEM Case No. 13-53485-BEM US Bankruptcy Court Northern District Georgia, Atlanta Division	X	X
Starr International Company, Inc. v. United States of America and American International Group, Inc. Case No. 11-CV-00779- TCW United States Court of Federal Claims	X	
Jeffrey Soffer, et. al. v. Five Mile Capital Partners LLC, et. al. Case No. 2:12-cv-01407 United States District Court for the District of Nevada	X	

Fort Henry Mall Owner, LLC v. U.S. Bank, NA, as Trustee for the Registered Holders of ML-CFC Commercial Mortgage Trust 2007-5, Commercial Mortgage Pass-Through Certificates, Series 2007-5 et. al. Civil Action No. 2:11-cv-00287 United States District Court For The Eastern District Of Tennessee At Greeneville	X	
Bank of America, National Association, as successor by merger to LaSalle Bank National Association v. LaSalle Commercial Mortgage Securities, Inc., Series 2006-MF4 Trust, acting by and through its Master and Special Servicer, Midland Loan Services, a division of PNC Bank National Association, and whose Trustee is Wells Fargo Bank, N.A. Case No. 12 cv 09612 LaSalle Commercial Mortgage Securities, Inc., Series 2006-MF4 Trust, acting by and through its Master and Special Servicer, Midland Loan Services, a division of PNC Bank National Association, and whose Trustee is Wells Fargo Bank, N.A. against Bank of America, N.A. as successor in interest to LaSalle Bank National Association Case No. 13 cv 05605 United States District Court for the Northern District of Illinois Cases consolidated for purposes of discovery.	X	
The Bank of New York Mellon, solely as Trustee for GE-WMC Mortgage Securities Trust 2006-1 v. WMC Mortgage LLC and GE Mortgage Holding, LLC Civil Action No. 12-CF-07096 (DLC) United States District Court Southern District of New York	X	
SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. AEQUITAS MANAGEMENT, LLC, et. al. Pending in the USDC Oregon		X

MEADE COMMUNITIES, LLC Plaintiff/Counterclaim-Defendant v. AMBAC ASSURANCE CORPORATION Defendant/Counterclaim-Plaintiff. Civil No. 02-cv-15-003745 Circuit Court for Anne Arundel County, Maryland Civil Division	X	
MONTEREY BAY MILITARY HOUSING, LLC, et al. & MONTEREY BAY LAND, LLC Plaintiffs v. AMBAC ASSURANCE CORPORATION Defendant Case No. 15CV000599 Superior Court of the State of California, County of Monterey	X	
FIVE MILE CAPITAL WESTIN NORTH SHORE SPE LLC Plaintiff v. BERKADIA COMMERCIAL MORTGAGE, LLC, et al. Defendant Case No. 12 CH 10805	X	X
AMBAC ASSURANCE CORPORATION Plaintiff v. RILEY COMMUNITIES, LLC Defendant Case No. 2016-CV-000026 District Court of Shawnee, County Kansas	X	
AMBAC ASSURANCE CORPORATION Plaintiff v. FORT BLISS/WHITE SANDS MISSILE RANGE HOUSING LP Defendant Case No. 2016DCV0094 El Paso County - 205th District Court	X	

499 Thornall Street Owner, LLC, Plaintiff vs. CW Capital Asset Management LLC, Mission Peak Capital, Inc., BOF, LLC, BOF Metropark Corporate Campus II, L.L.C., J. P. Morgan Chase Commercial Mortgage Securities Trust 2006-LDP9, U.S. Bank National Association, as Trustee for the registered holders of J.P. Morgan Chase Commercial Mortgage Securities Trust 2006-LDP9 Commercial Mortgage Pass-Through Certificates, Series 2006-LDP9 and Midland Loan Services, a division of PNC Bank, National Association Defendants Superior Court of New Jersey, Law Division: Middlesex County Docket No: L-2148-16, L-6801-16 (Consolidated)	X	
WOODBRIDGE GROUP OF COMPANIES, LLC, et al., jointly IN THE UNITED STATES BANKRUPTCY COURT DISTRICT OF DELAWARE Administered Case No. 17-12560 (KJC)	X	X
In re RAIT PREFERRED FUNDING II, LTD. vs. CWCAPITAL ASSET MANAGEMENT, LLC, U.S. BANK NATIONAL ASSOCIATION, in its capacity as Trustee Successor-In-Interest, and WELLS FARGO BANK NATIONAL ASSOCIATION SUPREME COURT OF THE STATE OF NEW YORK COUNTY OF NEW YORK Index No. 651729/2016	X	

Appendix B – *Summary of FTI Valuation Methodology*

For the assets for which the Debtors' did not procure 3rd party value opinions, FTI employed standard valuation techniques to estimate proceeds for each asset. The depth of analysis for each asset was determined by criteria used to identify potential high-value assets. The values were informed by actual Sears/Kmart transaction data, market data gleaned from relevant appraisals and CoStar rent data for small properties.

FTI's value approach and key assumptions are summarized in the following table.

Assets	Valuation Approach	Key Assumptions	Overlays
Owned	▪ Dark value methodology based on ability of buyer to re-tenant stores at market rents ▪ Valued on a direct cap basis on Stabilized NOI or a $/SF basis ▪ Stabilized NOI and/or $/SF estimated from complementary appraisals and/or CoStar reports	▪ Valued using cap rates from CoStar or complementary appraisals on Stabilized NOI ▪ Cap Rate range between 6.0%-9.0% ▪ Market rents were taken from CoStar and complementary appraisals ▪ $/SF metrics were taken from historic sales of Sears/Kmart stores and complementary appraisals ▪ Repositioning costs vary by product type and assume spaces are re-tenanted without changes to building layouts	▪ None
Lease / Ground Lease	▪ Dark value methodology based on ability to re-tenant stores at market rents ▪ Allocated a repositioning expense required to achieve market rents ▪ Valued on a DCF basis over the shorter of fully extended lease term or 50 years less contract rent	▪ Valued using a DCF of the rent arbitrage between rent expense and current market rents using a 12%-15% discount rate ▪ Arrived at market rents PSF through complementary appraisals and other market data, adjusted for anchor/big box format via 40%-60% discount when appropriate ▪ Repositioning costs vary by product type and assume spaces are re-tenanted without changes to building layouts ▪ Market leasing assumptions include 5-year terms and 70% renewal probability	▪ No value ascribed if remaining lease term is less than 10 years ▪ Values of non-REIT assets discounted by 50% if remaining lease term is between 10-15 years ▪ No value ascribed to Seritage leases with 100% recapture rights ▪ Values of remaining Seritage leases assume 50% recapture

Appendix C – Additional Portfolio Stratifications

FTI Estimated Market Values and Range of Estimated Sales Proceeds
By Ownership Type
($ in millions)

[redacted]

FTI Estimated Market Values and Range of Estimated Sales Proceeds
By SHC Format Type
($ in millions)

[redacted]

Appendix D– Documents Considered

- Sears_RE_Valuation.xlsm
- JLL Value Correction Model No Op Ex 01 23 2019 5 30 pm.xlsx
- JLL January 2019 Appraisals (297)
- JLL 2018 Appraisals (XX)
- C&W Appraisals (XX)
- 2019-1 14 Wind Down Recoveries (ESL) (002) FINAL_WEIL_96872332_2.pdf
- Broker Valuations UPD 12-17-18.xlsx
- DRAFT - UE CF estimate analysis v20190113.002.xlsx
- DRAFT encumbered analysis v20190114.002.pdf
- DRAFT encumbered analysis v20190114.002.xlsx
- DRAFT UE CF estimate analysis v20190113.002.pdf
- Encumbered Properties by Facility v20181029.001.xlsx
- Active unit and REID v20190108.xlsx
- Encumbered Real Estate_REVISED (as of 2018.10.29) (2).xlsx
- JLL A&G values v20181128.001.xlsx
- JLL Offer Summary 1-07-19.xlsx
- Sears Leased Assets Summary Sheet 2019.01.12.xlsx
- Sears Leased Assets Summary Sheet 2019.01.13.xlsx
- Sears Portfolio, 103 owned US assets.xlsx
- Unencumbered Properties v20181029.001.xlsx
- Unencumbered Real Estate_REVISED (as of 2018.10.29) (2).xlsx
- 300 Penry Rd Greensboro NC.pdf
- 901 N Federal Ft Lauderdale.pdf
- 1045 - Durham 1620 Guess Rd.pdf
- 1219 S Boone Aberdeen WA.pdf
- 2300 Hilltop.pdf
- 3456 Meyers Ave Memphis TN.pdf
- 6910 Fayetteville Durham NC.pdf
- Chicago Il Ind.pdf
- Durham NC.pdf
- East Bay CA.pdf
- Ft Lauderdale FL.pdf
- Greensboro NC Ind.pdf
- Groveport OH Ind 2.pdf
- Groveport OH Ind.pdf
- Memphis TN Ind.pdf
- Q3 2018 U.S. Retail Figures.pdf
- Sears Sales 4Q 2016 Cincinnati OH +.pdf
- Sears Sales 4Q216 Selected States 2.pdf
- Sears Sales 4Q2016 Bensalem PA.pdf
- Sears Sales 4Q2016 Bethesda MD.pdf
- Sears Sales 4Q2016 Cambridge MA.pdf
- Sears Sales 4Q2016 Goleta CA.pdf

- Sears Sales 4Q2016 Louisville KY.pdf
- Sears Sales 4Q2016 Pleasanton CA.pdf
- Sears Sales 4Q2016 Pompano Beach FL.pdf
- Sears Sales 4Q2016 Whitehall PA.pdf
- Sears Sales 12 01 2017.pdf
- Sears Sales Export v2.xlsm
- Sears Sales Export.xlsm
- Springfield MA.pdf
- Sears Sales 4Q2016 on Selected States.pdf
- CoStar Zip Code Markets.xlsx
- CoStar Retail Markets.xlsx
- 4 Properties.xlsx
- 181128 Real Estate - JLL (Owned + Subleases).xlsx
- 181129 U-Haul Transaction Memo.pdf
- Property file loan reconciliation v20181220.001.xlsx
- Property Sale History (March 2018).pdf
- R Puerto email.pdf
- RE_ #1678 Carlsbad - Lease expiration.pdf
- Re_ Amerco Transaction.pdf
- RE_ Discussion on Property Sale History.pdf
- RE_ FTI _ HL Diligence - 12_19_18 2.pdf
- RE_ FTI _ HL Diligence 12_19_18.pdf
- Re_ PRIORITY_ Anchorage - ownership classification.pdf
- Re_ Property Values Discussion.pdf
- RE_ Sears_ Updated_Consolidated Requests.pdf
- RE_ Sears_ Vacant Land SF_Acreage Immediate Need.pdf
- Sales History Questions_v2 - RP 12.23.18 2.docx
- Sales History Questions_v2 - RP 12.23.18.docx
- Sears Property Sale History 5-3-18_v1.xlsx
- Seritage Recapture Info_12.21.18.xlsx
- TRU - First Report of Fee Examiner 10.29.2018.docx
- UUC Questions Manteno IL - Greensboro NC - Groveport OH.docx
- costarbigbookindustrial.pdf
- Email_Miii_20190113_1541EST.pdf
- Email_Miii_20190113_1746EST.pdf
- Email_Miii_20190114_2136EST.pdf
- PWC Real Estate Investor Survey 2018 Q2.pdf
- PWC Real Estate Investor Survey 2018 Q3.pdf
- RCA Capital Trends Retail Oct-2018.pdf
- RCA Commercial Property Price Indices Oct-2018.pdf
- RCA US All - Caps Yields and Spreads.xlsx
- RCA US All - Volume by TransType.xlsx
- RCA US Retail - Investor Composition.xlsx
- RCA US Retail - Market Stats.xlsx
- RCA US Retail - Volume and Pricing.xlsx
- Realty Rates Developer Survey 2018 Q1.pdf
- Realty Rates Investor Survey 2018 Q1.pdf

- Realty Rates Market Survey 2018 Q1.pdf
- Sale Listings - NJ - 6854.pdf
- Sales History Questions_v2 - RP 12.23.18.docx
- Sales History Questions_v2 - RP 12.23.18_A.docx
- Sales History Questions_v2 RP 12.23.18_B.docx
- Sears Property Sale History 5-3-18.xlsx
- Sears Response to Questions re Property Rights.xlsx
- Sears Valuation Analysis - TI & LC Assumptions_RCA_v3.xlsx
- Sears_RE Bids Received_20181228_4871 & 6854.xlsx
- Supplemental Property Info - CA - 1268.pdf
- Supplemental Property Info - CA - 1388.pdf
- Supplemental Property Info - NJ - 6854.pdf
- UUC Questions - Manteno IL - Greensboro NC Groveport OH.docx
- 4 Properties - Clarification from Sears.xlsx
- 181128 Real Estate - JLL (Owned + Subleases).xlsx
- A&G Rent Estimates - 7 Properties.xlsx
- C&W Capital Markets Update 11-28-18.pdf
- C&W Rate Summary.xlsx
- Comparable Sales & Listings - CA - Fresno Industrial.pdf
- Comparable Sales & Listings - NC - 3096100.pdf
- Comparable Sales & Listings - PR - Industrial.pdf
- Comparable Sales & Listings - PR - Retail.pdf
- Comparables Sales & Listings - PR.xlsx
- Costar Lease Comps Summary CA - Santa Barbara.pdf
- Costar Lease Comps Summary CA - Stockton.pdf
- Costar Lease Comps Summary - CO - Boulder.pdf
- Costar Lease Comps Summary - CO - Ft Collins.pdf
- Costar Lease Comps Summary - FL - Ft Walton.pdf
- Costar Lease Comps Summary - FL - Jacksonville.pdf
- Costar Lease Comps Summary - FL - Palm Beach.pdf
- Costar Lease Comps Summary - LA - New Orleans.pdf
- Costar Lease Comps Summary - MA - Boston.pdf
- Costar Lease Comps Summary - MI - Detroit.pdf
- Costar Lease Comps Summary - MO - Joplin.pdf
- Costar Lease Comps Summary - MO - St Louis.pdf
- Costar Lease Comps Summary - MS.pdf
- Costar Lease Comps Summary - NC - Charlotte.pdf
- Costar Lease Comps Summary - NC - Durham.pdf
- Costar Lease Comps Summary - NC - Raleigh.pdf
- Costar Lease Comps Summary - NY - Poughkeepsie.pdf
- Costar Lease Comps Summary - TN - Nashville.pdf
- Costar Lease Comps Summary - TX El Paso.pdf
- Costar Lease Comps Summary - VA - Richmond.pdf
- Costar Lease Comps Summary - WA - Olympia.pdf
- Costar Lease Comps Summary - WA - Seattle.pdf
- Costar Lease Comps Summary - WA - Yakima.pdf
- Costar Underwriting Report - NC - 30961.pdf

- Costar Underwriting Report - TN - 446.pdf
- Cushman Wakefield Appraisal Summary (2018.08.20).xlsx
- Dispositions 2016-Present.xlsx
- FTI Calculations Model 12 05 2018.xlsx
- FTI Items - Jane Borden.xlsx
- FTI Holding Costs Calculations 01222019.xlsx
- TI Market Rent Comparables Analysis.xlsx
- FTI Preliminary Mkt Rent Estimate - #7259.xlsx
- FTI Preliminary Mkt Rent Estimates - Lease Rejections.xlsx
- FTI Preliminary Mkt Rent Estimates.xlsx
- Summary of Assets with Duplicate Unit #s.xlsx
- FTI Rate Summary.xlsx
- Jane Borden Email 12-24 18 re FTI & HL Due Dilligence.pdf
- Land Sizes - Jane Borden.pdf
- Lease Comps Supporting Docs - AZ - 1728.pdf
- Lease Comps Supporting Docs - CA - 3174.pdf
- Lease Comps Supporting Docs - CA - 3748.pdf
- Lease Comps Supporting Docs - CA - 4349.pdf
- Lease Comps Supporting Docs - CA 8287.pdf
- Lease Comps Supporting Docs - CA Inland Empire.pdf
- Lease Comps Supporting Docs - CA - Los Angeles.pdf
- Lease Comps Supporting Docs - CA Sacramento.pdf
- Lease Comps Supporting Docs - CO - 8290.pdf
- Lease Comps Supporting Docs - CO.pdf
- Lease Comps Supporting Docs - CT.pdf
- Lease Comps Supporting Docs - FL.pdf
- Lease Comps Supporting Docs - HI 8818.pdf
- Lease Comps Supporting Docs - HI.pdf
- Lease Comps Supporting Docs - IN.pdf
- Lease Comps Supporting Docs - LA - 4810.pdf
- Lease Comps Supporting Docs - MA - 1223.pdf
- Lease Comps Supporting Docs - MD.pdf
- Lease Comps Supporting Docs - MI - 1092.pdf
- Lease Comps Supporting Docs - MI - 3155.pdf
- Lease Comps Supporting Docs - MI - 9693.pdf
- Lease Comps Supporting Docs - MO - 1042.pdf
- Lease Comps Supporting Docs - MS - 1166.pdf
- Lease Comps Supporting Docs - NC - 3667.pdf
- Lease Comps Supporting Docs - NJ - 6854.pdf
- Lease Comps Supporting Docs - NV.pdf
- Lease Comps Supporting Docs - NY - Long Island.pdf
- Lease Comps Supporting Docs - NY - Manhattan.pdf
- Lease Comps Supporting Docs - NY - Newburgh.pdf
- Lease Comps Supporting Docs - OH.pdf
- Lease Comps Supporting Docs - PA.pdf
- Lease Comps Supporting Docs - SC.pdf
- Lease Comps Supporting Docs - TN - 1386.pdf

- Lease Comps Supporting Docs - TX - 447.pdf
- Lease Comps Supporting Docs - TX - 1317.pdf
- Lease Comps Supporting Docs - VA - 1274.pdf
- Lease Comps Supporting Docs - VA - 7259.pdf
- Lease Comps Supporting Docs - WA - 1139.pdf
- Lease Comps Supporting Docs - WA - 2029.pdf
- Property Sale History (March 2018).pdf